



# MADE IN PRD

Challenges & Opportunities  
for HK Industry

Research Team  
The H.K. Centre for Economic Research  
Presented by  
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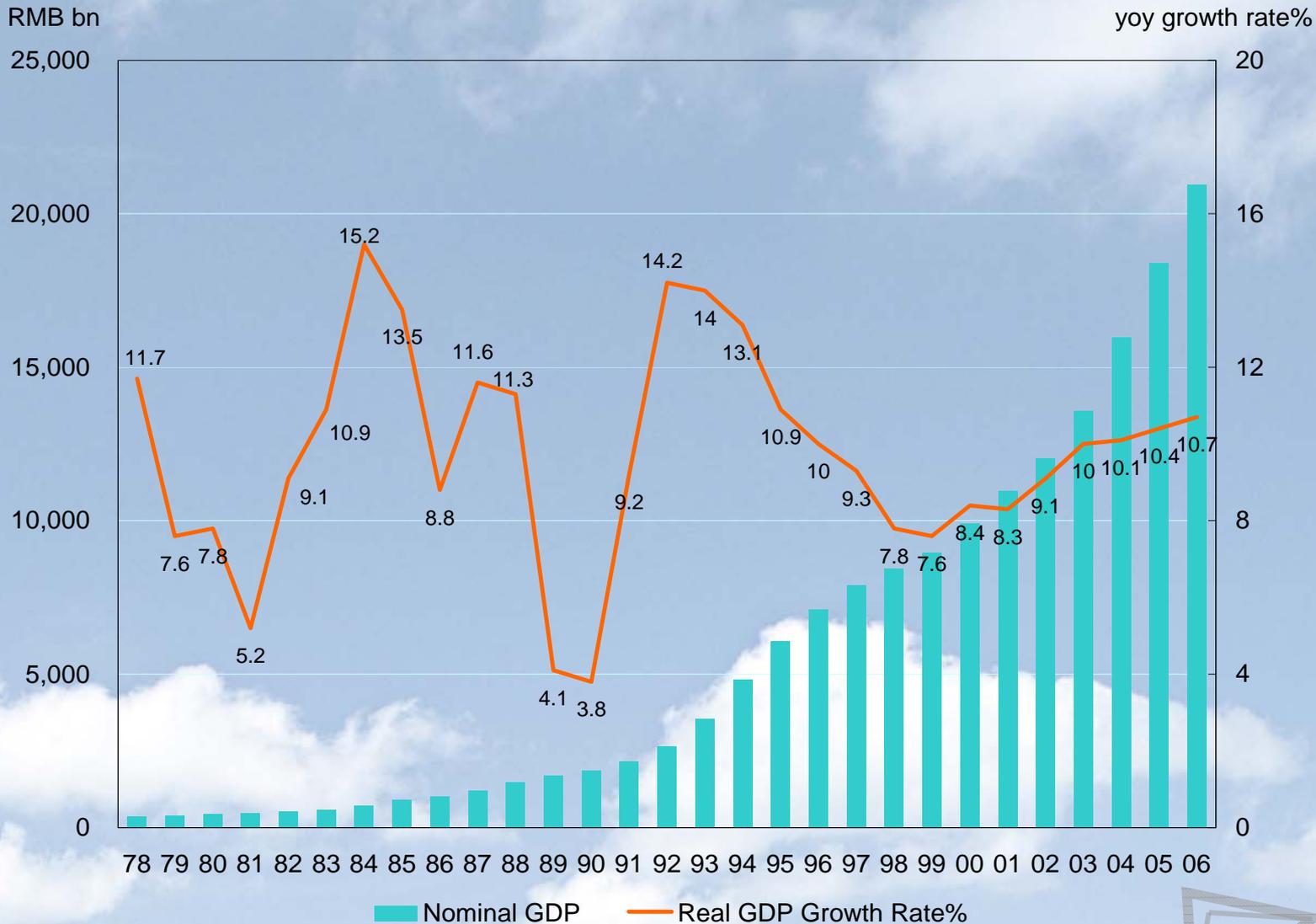


# Rise of China

- China's economy has continued to grow at a rapid rate since 1978
- No signs of abatement with an average annual real GDP growth rate of 9.8% since 2000 (2006 GDP growth: 10.7%)
- Consumer price inflation averaged 1.36% since 2000
- The world's fourth-largest economy in 2005 (just behind US, Japan and Germany)
- The world's third largest exporter in 2005 (the largest exporter of Information Technology Goods in 2004 & 2005 )
- The world's third largest R&D expenditure (2004)
- The world's largest holder of foreign exchange reserves in 2006
- Two of most vibrant economic regions in China
  - The Pearl River Delta (PRD)
  - The Yangtze River Delta (YRD)

# China's economy has continued to grow at a rapid rate since 1978

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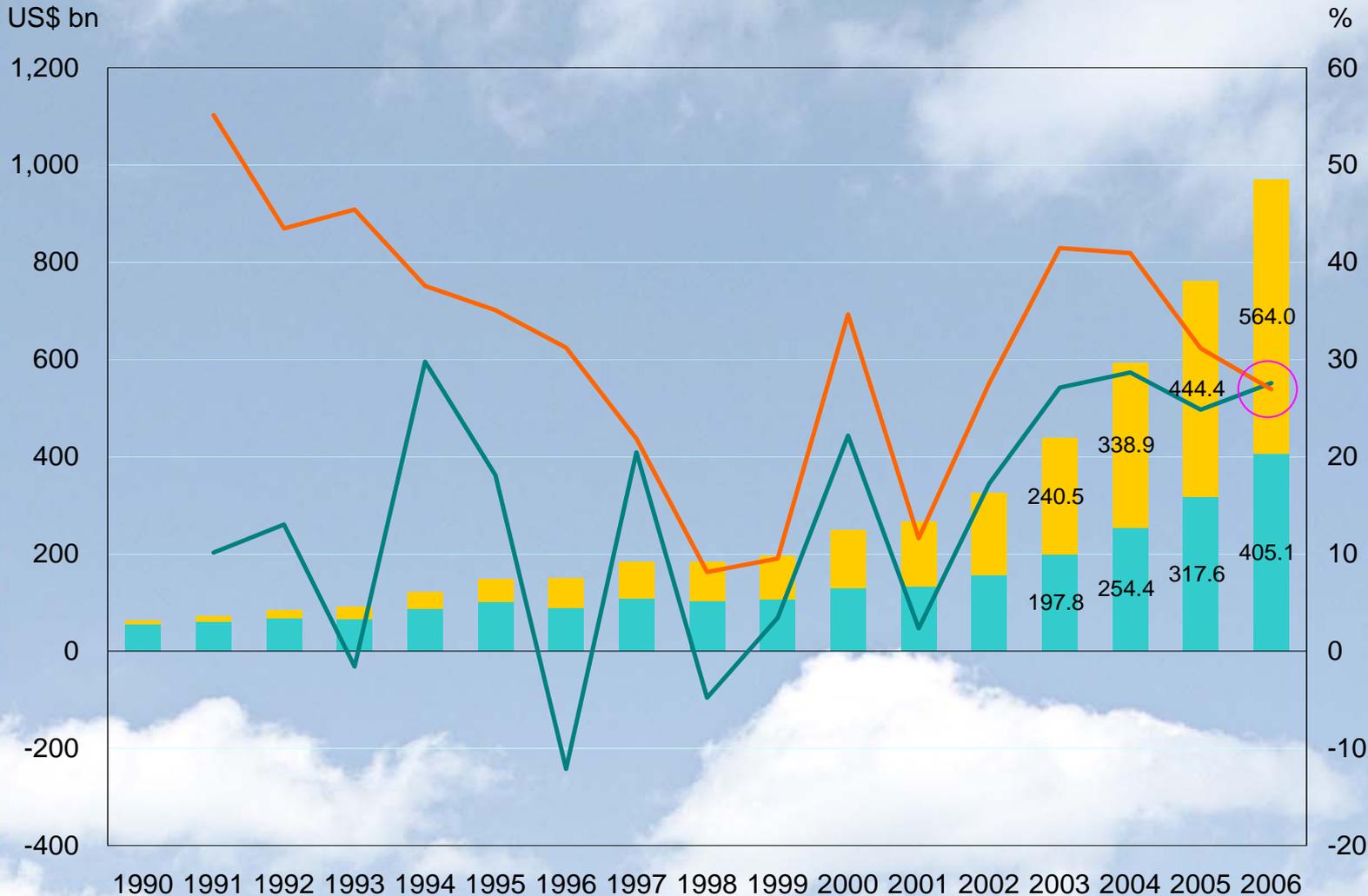


Source: National Bureau of Statistics of China, CEIC

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# Foreign Invested Enterprises (FIEs) have played an important role in China's trade performance



■ Domestic Enterprises      ■ Foreign Invested Enterprises(FIEs)  
— Domestic Enterprises (yoy growth rate %)      — FIEs (yoy growth rate %)

Source: CEIC





## Two of Most Vibrant Economic Regions in China Greater PRD (Guangdong) and Greater YRD

- 4.1% of total land area of China
- 18.4% of total population of China in 2005
- 40% of total nominal GDP in 2005
- 55% of total FDI in 2005
- 75% of total exports from Foreign Invested Enterprises (FIEs) in 2005
- 85% of total exports in 2005
- 105% of the overall trade surplus in 2005

# Greater Pearl River Delta (PRD) region Guangdong, Hong Kong and Macao

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	Hong Kong	Macao	Guangdong	Greater PRD Economic Region
Area (sq km)	1,104	25.8	179,757	<b>180,887</b>
Population (mn)*	6.97	0.49	91.94	<b>99.40</b>
GDP (USD bn)*	177.76	11.56	273.00	<b>462.5</b>
GDP per capita (USD)*	25,629	23,678	2,970	<b>4,653</b>

\*Figures in 2005

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# Greater Yangtze River Delta (YRD) Economic Region Shanghai, Jiangsu and Zhejiang

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	Shanghai	Jiangsu	Zhejiang	Greater YRD Economic Region
Area (sq km)	6,300	102,600	103,636	<b>212,536</b>
Population (mn)*	17.78	74.75	48.94	<b>141.47</b>
GDP (USD bn)*	111.7	223.4	164.0	<b>499.1</b>
GDP per capita (USD)*	6,283	2,989	3,351	<b>3,528</b>

\*Figures in 2005

Made in PRD(ii)

# Hong Kong vs Shanghai Greater PRD vs Greater YRD(2005)

	Hong Kong	Shanghai	Greater PRD	Greater YRD
<b>Nominal GDP (USD bn)</b>	<b>177.9</b>	<b>111.7</b>	<b>462.5</b>	<b>499.1</b>
<i>Industry</i>	<b>6.4%</b>	<b>45.1%</b>	<b>30.3%</b>	<b>48.4%</b>
<i>Services</i>	<b>90.6%</b>	<b>50.5%</b>	<b>60.9%</b>	<b>40.3%</b>
<b>Estimates of Exports Destined to and Retained Imports from Areas other than Hong Kong, Macao, or the Mainland</b>				
<b>Estimated Total Trade (USD bn)</b>	<b>123.6</b>	<b>176.7</b>	<b>463.9</b>	<b>493.7</b>
Estimated Exports (USD bn)	<b>51.0</b>	<b>82.2</b>	<b>206.0</b>	<b>265.5</b>
Estimated Retained Imports (USD bn)	<b>72.6</b>	<b>94.5</b>	<b>257.8</b>	<b>228.2</b>
<b>FDI (USD bn)</b>	<b>35.9</b>	<b>6.9</b>	<b>49.6</b>	<b>27.8</b>
Estimated FDI, originated from areas other than HK, Macao or Mainland China	<b>27.5</b>	<b>6.0</b>	<b>34.4</b>	<b>19.9</b>
<b>Deposits in Banks (USD bn)</b>	<b>523.2</b>	<b>284.6</b>	<b>1,004.9</b>	<b>810.8</b>
<i>Loans to Deposits Ratio %</i>	<b>56.8%</b>	<b>72.0%</b>	<b>58.4%</b>	<b>74.2%</b>

Source: CEIC. Other figures are from Guangdong, Jiangsu, Shanghai, Zhejiang Statistical Reports 2005, HKSAR Census and Statistics Department, Macao SAR Statistics and Census Bureau

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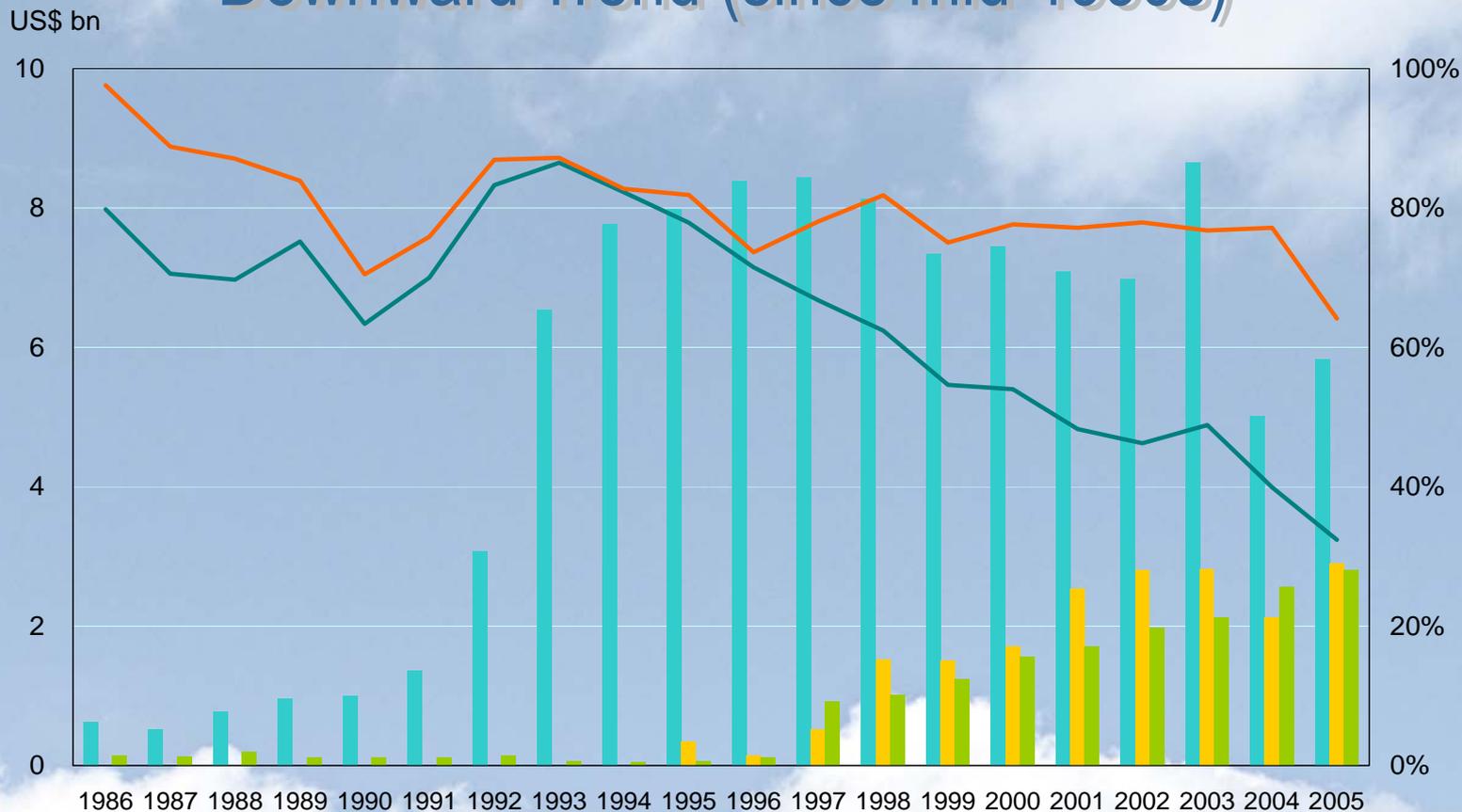
## Hong Kong

### - the Single Largest Source of FDI in China

- The single largest source of foreign direct investment (FDI) in Guangdong, Shanghai, Jiangsu and Zhejiang
- 65% or US\$105.4 billion of total cumulative FDI invested in Guangdong as at the end of 2005
- 31% or US\$61 billion of total cumulative FDI invested in Greater YRD during 1992-2005

# FDI from Hong Kong in Guangdong - Downward Trend (since mid-1990s)

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- a. FDI from HK
- b. FDI from Major Tax Haven Countries(BVI, Cayman Islands, Bermuda, Bahamas and Western Samoa)
- c. Other Foreign Investment (Processing and Assembly(PA)/Compensation Trade(CT))
- FDI from HK as a % of Guangdong's Total FDI plus other foreign investments
- FDI from HK and Tax Haven Economies plus other foreign investment as % of Guangdong's Total FDI plus Other Foreign Investment

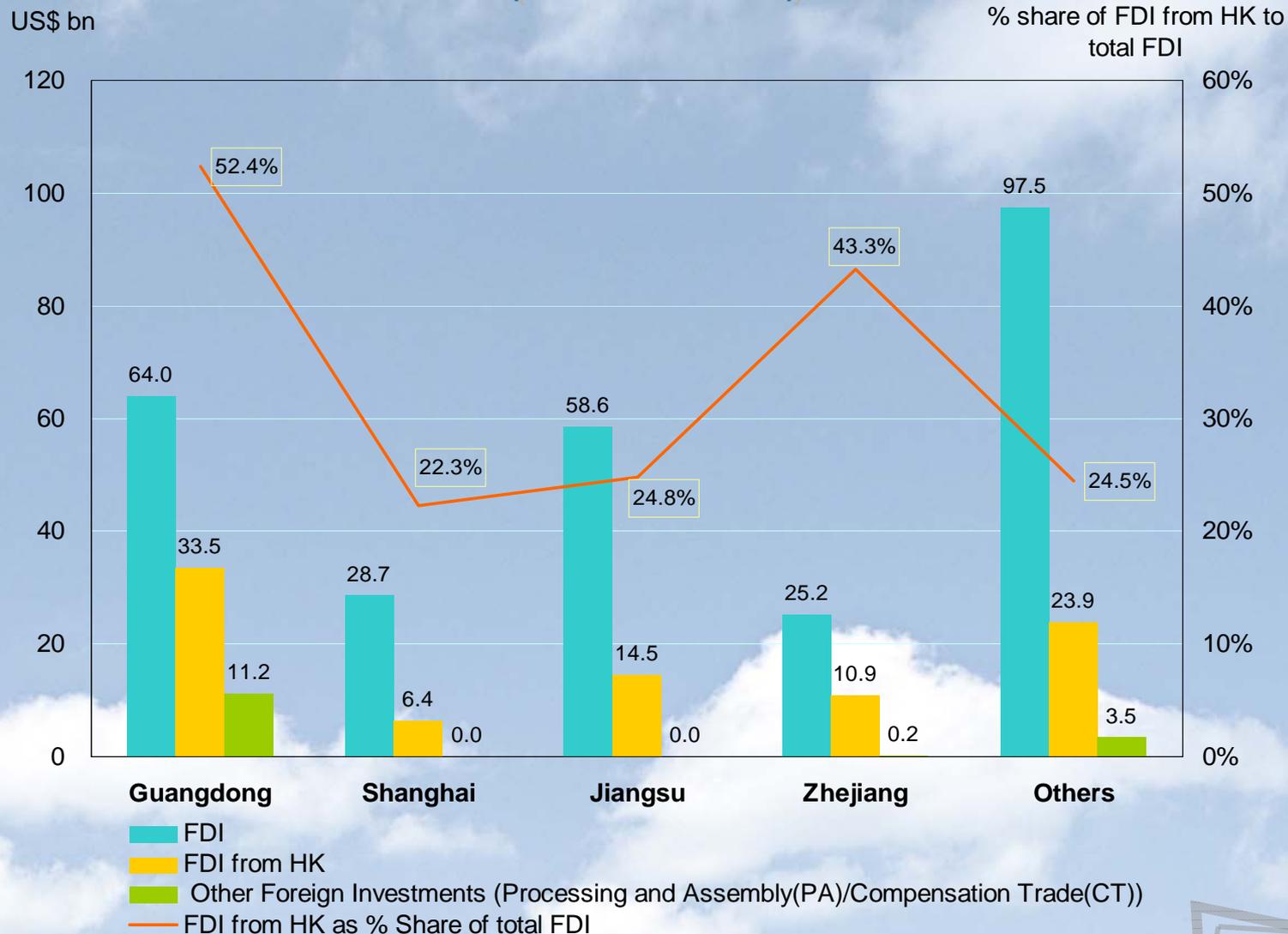
Source: Guangdong Statistical Yearbooks

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# Hong Kong – the single largest source of FDI into Guangdong, Shanghai, Jiangsu and Zhejiang (2001-2005)

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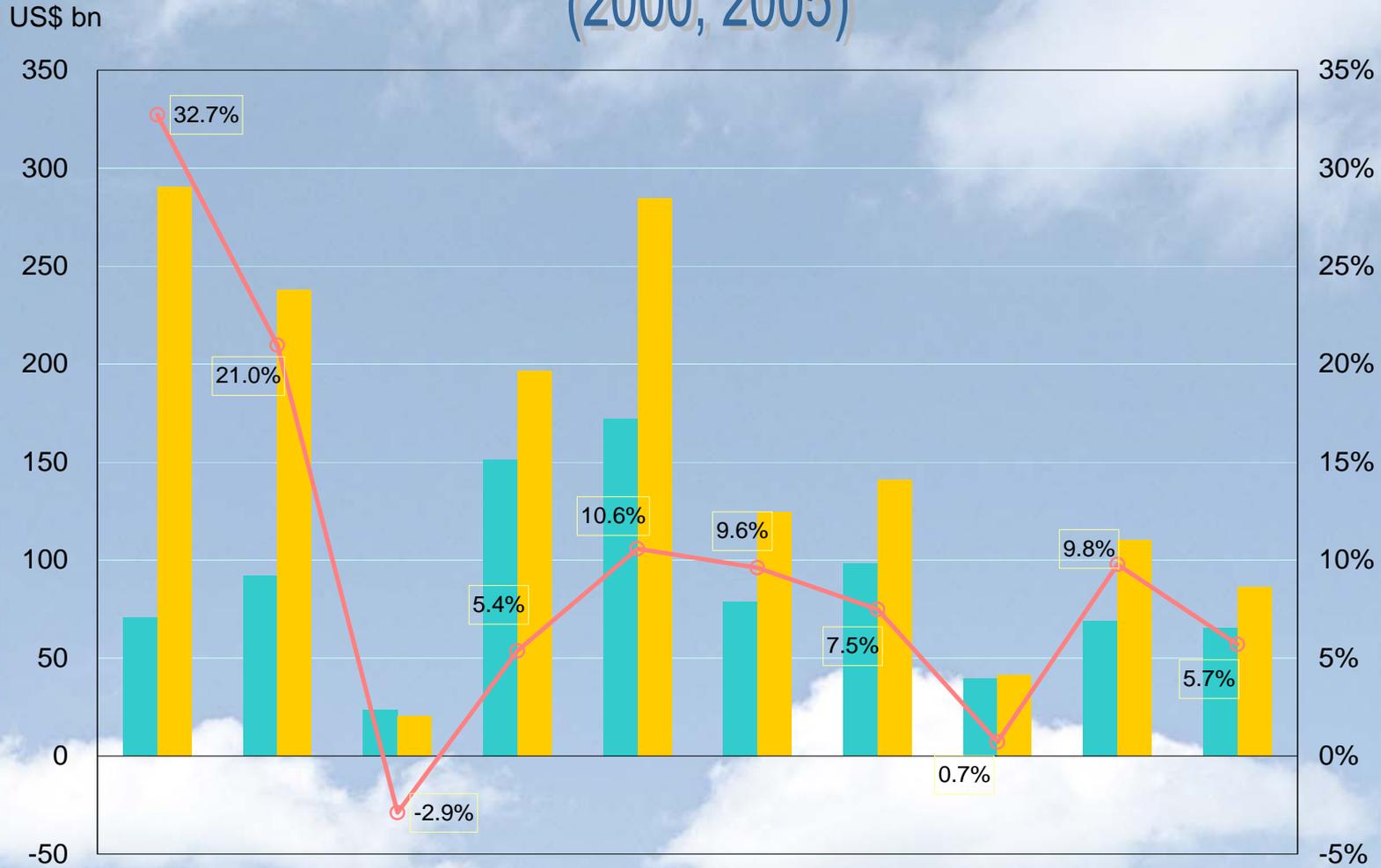


Source: Guangdong Statistical Yearbooks, Shanghai Statistical Yearbooks, Jiangsu Statistical Yearbooks, Zhejiang Statistical Yearbooks, China Statistical Yearbooks

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# Domestic Exports of Selected Asian Economies (2000, 2005)

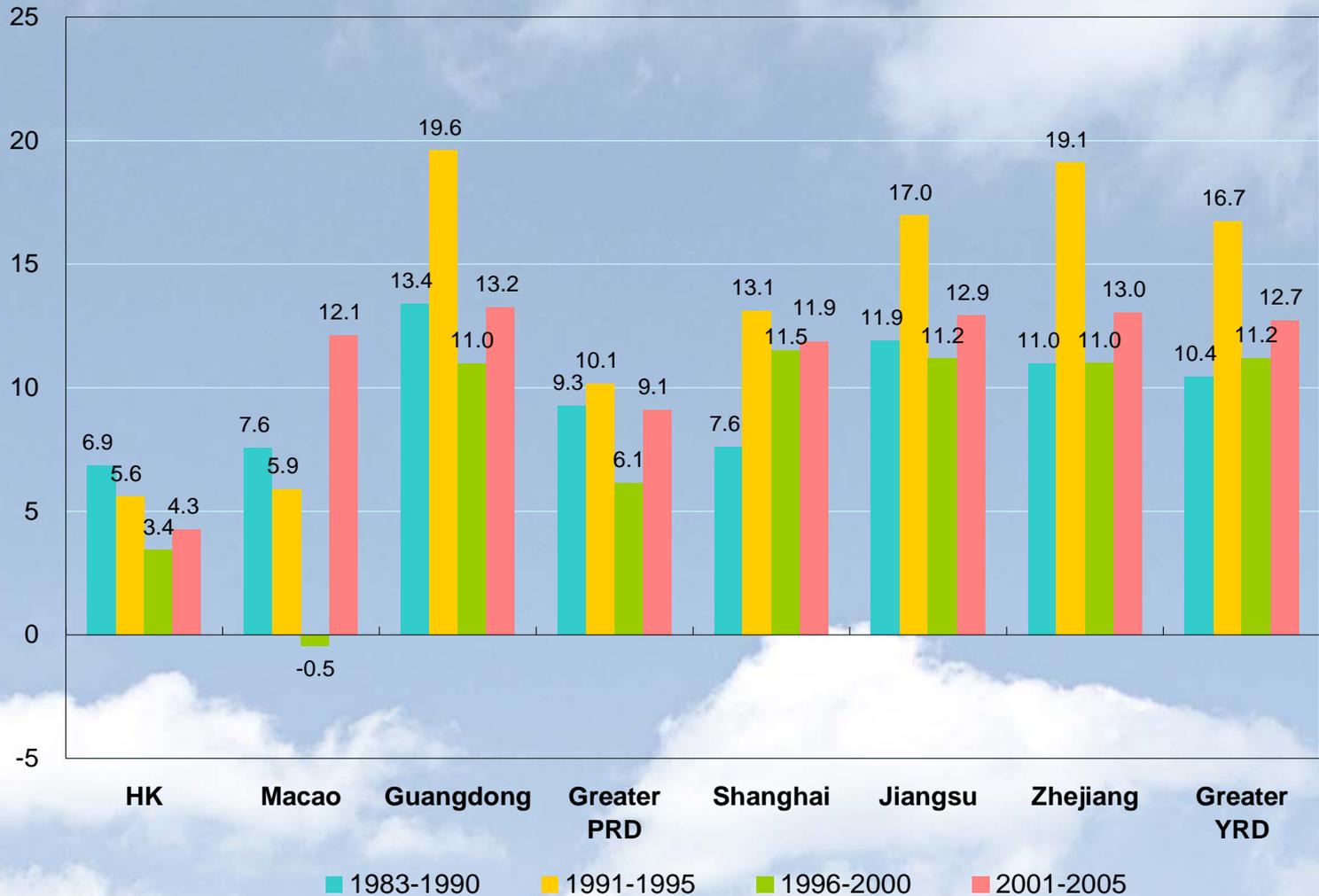


■ Domestic Exports in 2000   
 ■ Domestic Exports in 2005   
 —○— Average Annual Growth Rate(2001-2005)



# Greater PRD and Greater YRD Real GDP Growth

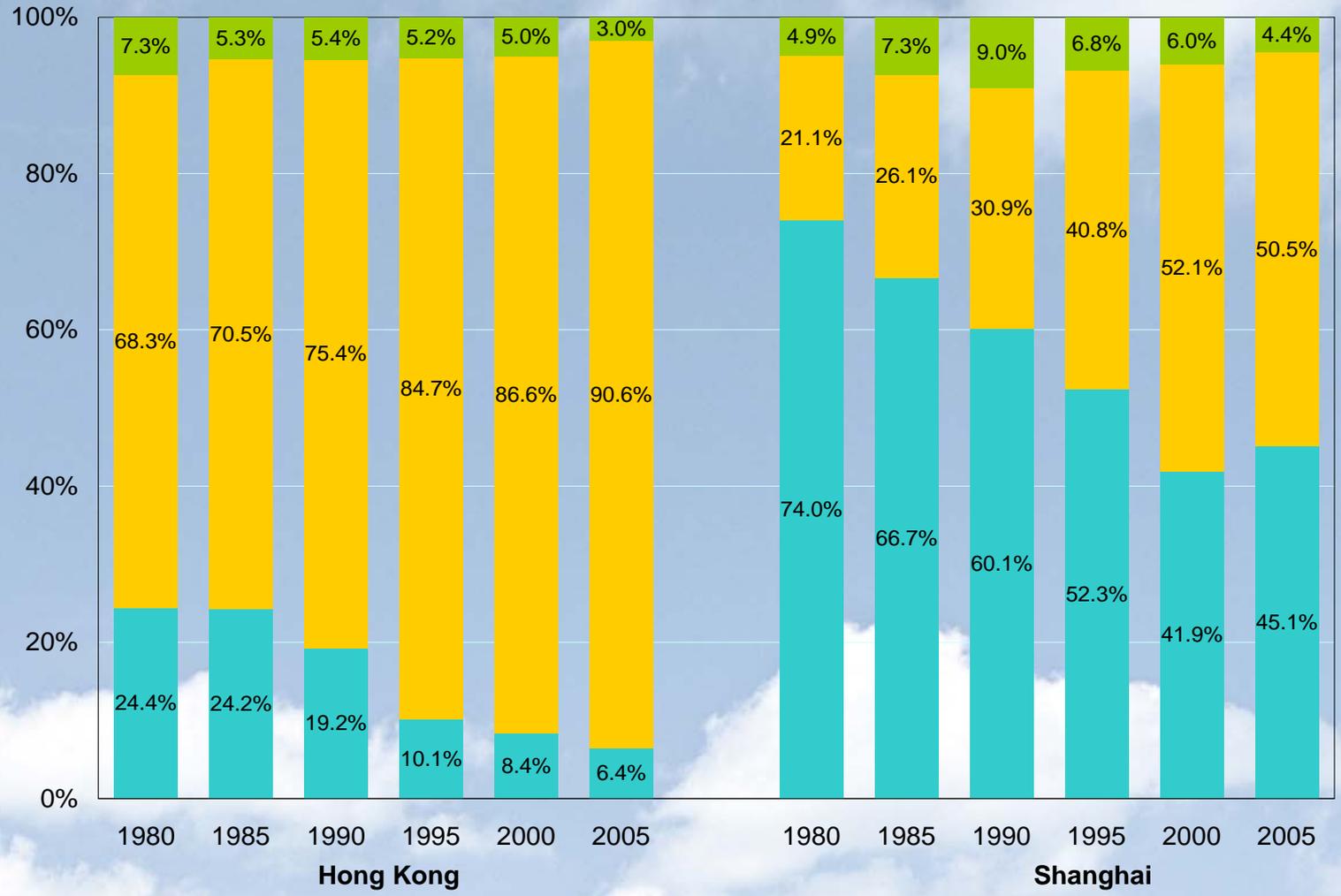
Average Annual  
Growth Rate (%)



Source: CEIC, Guangdong Statistical Yearbooks, Shanghai Statistical Yearbooks, Jiangsu Statistical Yearbooks, Zhejiang Statistical Yearbooks, China Statistical Yearbooks, Macao SAR Statistics and Census Bureau

# Hong Kong and Shanghai Industry and Total Services as % of Nominal GDP (1980-2005)

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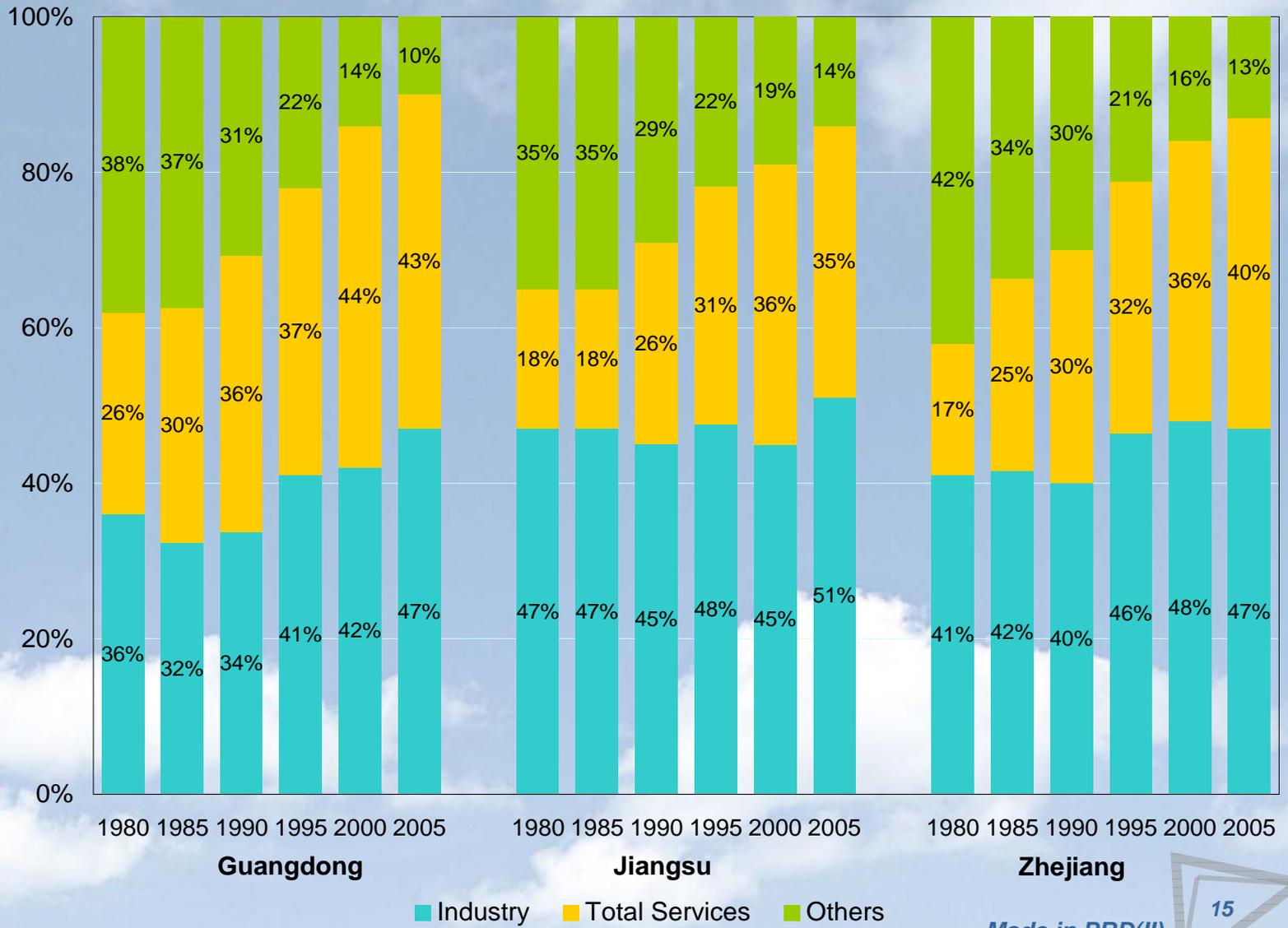


■ Industry   ■ Total Services   ■ Others

Source : CEIC and Shanghai Statistical Yearbook 2006

# Guangdong, Jiangsu and Zhejiang Industry and Total Services as % of Nominal GDP (1980-2005)

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Source: Guangdong Statistical Yearbook 2006, Jiangsu Statistical Yearbook 2006, Zhejiang Statistical Yearbook 2006



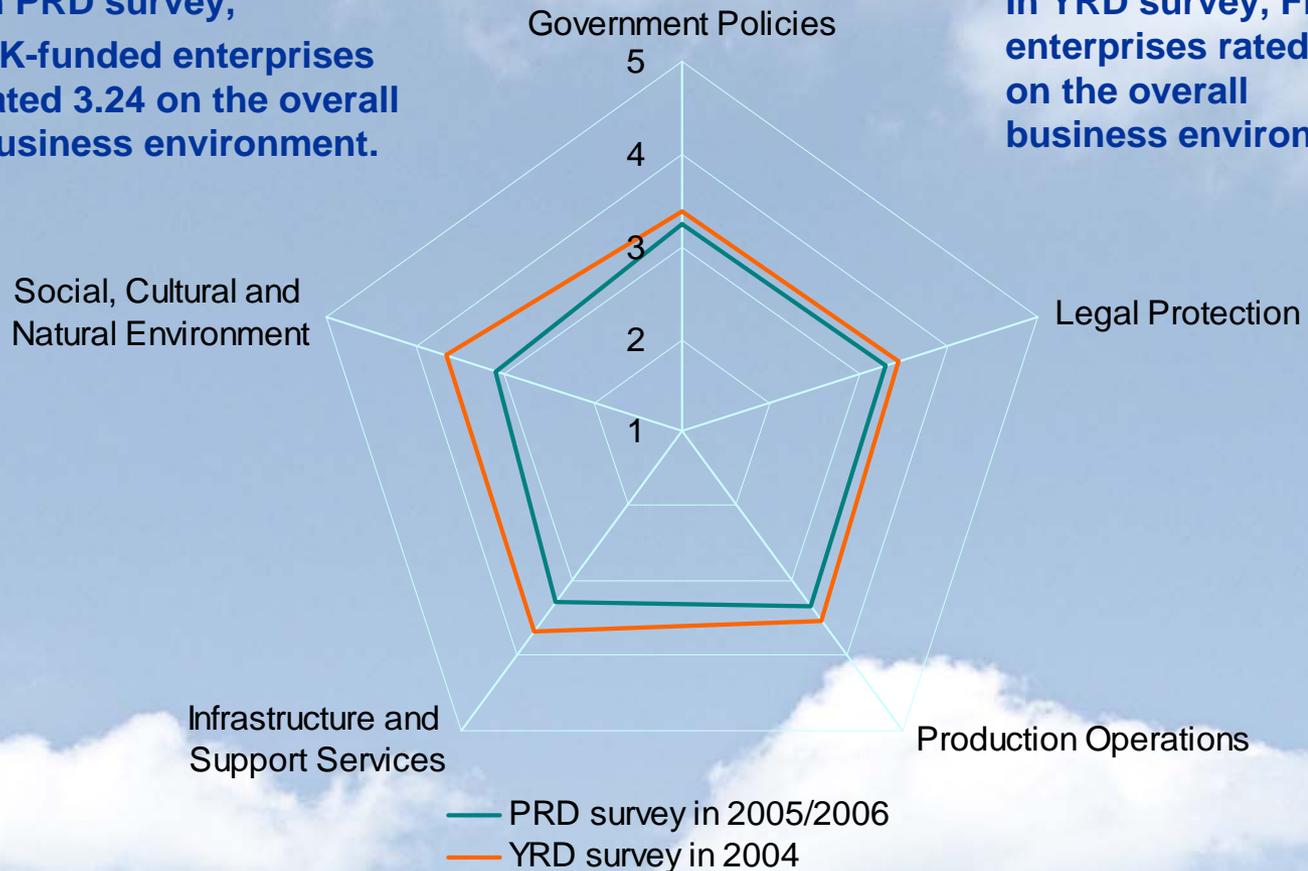
# Greater PRD and Greater YRD

- In 2001-2005, the average annual growth rate of exports from FIEs in Greater YRD was 40%, and that in Guangdong was 25.6%  
(In 2006, Greater YRD: 29.4%; Guangdong: 26.8%)
- The Greater YRD has overtaken Greater PRD in GDP term since 2004
- A lot of inland talent was attracted to working in Guangdong because of its rapid economic development in the 1990s
- During 2001-2005, the Greater YRD experienced Guangdong's explosive development mode from 1990s – attracting foreign investment, increasing export volume, attracting a population tertiary education
- Hong Kong Investors have gradually moved away from Guangdong to other areas around the country to seek the most favorable business opportunities

# Business Environments - Evaluating five aspects the YRD was slightly better than the PRD

In PRD survey,  
HK-funded enterprises  
rated 3.24 on the overall  
business environment.

In YRD survey, FIEs  
enterprises rated 3.54  
on the overall  
business environment.



1:Unsatisfied 2:Slightly unsatisfied 3:Neutral 4:Slightly satisfied 5:Satisfied





## Business Environment PRD(2005/06) vs YRD(2004)

- The ratings of the PRD and the YRD showed little difference in government policies and legal protection
- But it showed bigger difference in infrastructure & support services and social, cultural & natural environment
- Cities in the PRD had the lowest ratings in social, cultural and natural environment, especially in social security, living convenience and comfort, and the quality of living environment

# Hong Kong Producer Services

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- Hong Kong's position as an international city has supported both Mainland and multinational enterprises that were looking for a platform to stage their regional and even global operation
- Hong Kong(2006) - 1,228 regional headquarters, 2,509 regional offices, 2,509 local office
- About 87% of the regional headquarters managed business in Mainland China, of which about 72% were businesses in Guangdong
- The proportion of Hong Kong residents working in the Mainland to total employed persons was 7.6% in 2004. More than 80% of them were professionals or manager staff and worked in Guangdong

# Rising Support of HK Producer Services to the Mainland

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	1980	1985	1990	1995	2000	2005
	<b>Share % of Real GDP</b>					
<b>Manufacturing</b>	<b>14.6%</b>	<b>13.5%</b>	<b>14.0%</b>	<b>8.7%</b>	<b>5.4%</b>	<b>3.3%</b>
<b>Total Services</b>	<b>79.3%</b>	<b>79.5%</b>	<b>78.5%</b>	<b>83.6%</b>	<b>86.6%</b>	<b>90.8%</b>
<i><b>Producer Services</b></i>	<i><b>36.1%</b></i>	<i><b>31.6%</b></i>	<i><b>34.7%</b></i>	<i><b>41.7%</b></i>	<i><b>45.8%</b></i>	<i><b>52.8%</b></i>
Consumer Services	34.9%	38.4%	35.9%	33.6%	33.3%	31.4%
Government Services	8.3%	9.6%	7.9%	8.3%	7.6%	6.6%
<b>Others</b>	<b>6.1%</b>	<b>6.9%</b>	<b>7.5%</b>	<b>7.8%</b>	<b>8.0%</b>	<b>5.9%</b>

Source : CEIC; Y.C.R. Wong, Z. Tao and C.S. Chan, "An Economic Study of Hong Kong's Producer Service Sector and its Role in Supporting Manufacturing", Industrial Support Fund, May 2000; and Z. Tao and Y.C.R. Wong, "Hong Kong: From an Industrialized City to a Center of Manufacturing-Related Services", Urban Studies, vol. 39, no.12, 2002, pp. 2345-2358.

# Guangdong

## One of the Most Dynamic Manufacturing Bases

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	China			Guangdong		
	<i>Average Annual Growth Rate %</i>			<i>Average Annual Growth Rate %</i>		
	2000	2005	2001-2005	2000	2005	2001-2005
<b>GDP</b>						
at current price (RMB billion)	9,800	18,396	<b>13.4</b>	1,074	2,237	<b>15.8</b>
at comparable price (1978=100)	751	1,204	<b>9.9</b>	1,738	3,238	<b>13.2</b>
<b>Value Added of Industry</b>						
at current price (RMB billion)	4,003	7,691	<b>14.0</b>	446	1,048	<b>18.6</b>
at comparable price (1978=100)	1,119	1,879	<b>10.9</b>	3,423	7,371	<b>16.6</b>
GDP Per Capita (RMB)	7,858	14,040	<b>12.3</b>	12,418	24,327	<b>14.4</b>
GDP Per Capita (USD)	949	1,714	<b>12.5</b>	1,500	2,970	<b>14.6</b>
<b>Exports (US\$ billion)</b>	249.2	762.0	<b>25.0</b>	91.2	238.2	<b>21.2</b>
<b>FDI (US\$ billion)</b>	40.7	72.4	<b>12.2</b>	12.2	12.4	<b>0.2</b>

Source: China Statistical Yearbooks and Guangdong Statistical Yearbooks

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# The most vibrant economic region in Guangdong is the PRD Economic Zone

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# Major Economic Indicators in Hong Kong, Macao and the nine cities of PRD (2005)

		Area (sq km)	Population (Mn persons)	Nominal GDP (USD bn)	GDP per Capita (USD)
<b>Hong Kong</b>		<b>1,104</b>	<b>6.97</b>	<b>177.9</b>	<b>25,629</b>
<b>Macao</b>		<b>26</b>	<b>0.49</b>	<b>11.6</b>	<b>23,678</b>
<b>Guangdong</b>		<b>179,757</b>	<b>91.94</b>	<b>272.9</b>	<b>2,970</b>
<b>PRD</b>		<b>54,743</b>	<b>45.47</b>	<b>222.6</b>	<b>4,896</b>
Eastern PRD	Shenzhen	1,953	8.28	60.4	7,299
	Dongguan	2,465	6.56	26.6	4,058
	Huizhou	11,158	3.71	9.8	2,645
Central PRD	Guangzhou	7,434	9.50	62.9	6,623
Western PRD	Zhuhai	1,688	1.42	7.7	5,473
	Zhongshan	1,800	2.43	10.7	4,412
	Jiangmen	9,541	4.10	9.8	2,395
	Foshan	3,848	5.80	29.1	5,014
	Zhaoqing	14,856	3.68	5.5	1,496
<b>Other cities in Guangdong</b>		<b>125,014</b>	<b>46.47</b>	<b>57.7</b>	<b>1,242</b>

Source: Guangdong Statistical Yearbook 2006, HKSAR Census and Statistics Department, Macao SAR Statistics and Census Bureau



# Guangdong

Foreign Investment played an important role in the industrial development of each city





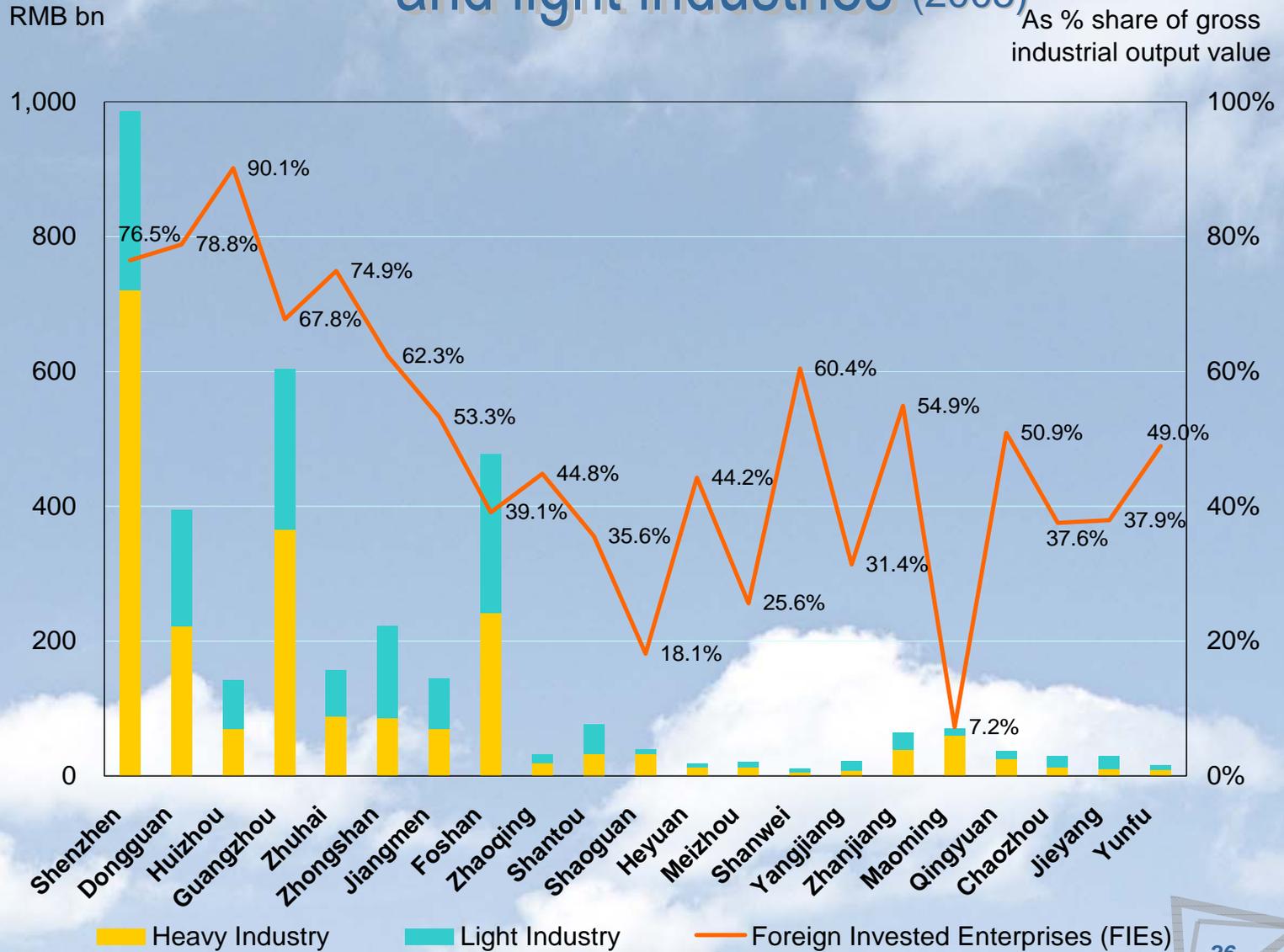
# Value Added of Industry, Foreign Investment and Exports in Guangdong

	<b>As % of total value added of industry (2005) in 21 Guangdong's cities</b>	<b>As % of Accumulated Foreign Investment (1989-2005) in 21 Guangdong's cities</b>	<b>As % share of total exports (2005) in Guangdong</b>
<b>Eastern PRD</b>	39.2%	37.2%	64.3%
<b>Central PRD</b>	17.7%	18.9%	11.2%
<b>Western PRD</b>	25.9%	25.6%	20.0%
<b>Other cities</b>	17.2%	18.2%	4.6%

Source: Guangdong Statistical Yearbooks

# FIEs play an important role in both heavy and light industries (2005)

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Source: Guangdong Statistical Yearbook 2006

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# Hong Kong Investment in Guangdong

- The industrial development of Guangdong was inextricably linked to foreign investment, which affected the industrial development scale of each city and drove the flow of human resources. Capital from or managed by Hong Kong played an important role.
- The cooperative level and scale between domestic enterprises and foreign enterprises in Guangdong (e.g. FIEs + OCFs) are undeniably the highest in the country.

## Our PRD Survey in 2005/2006

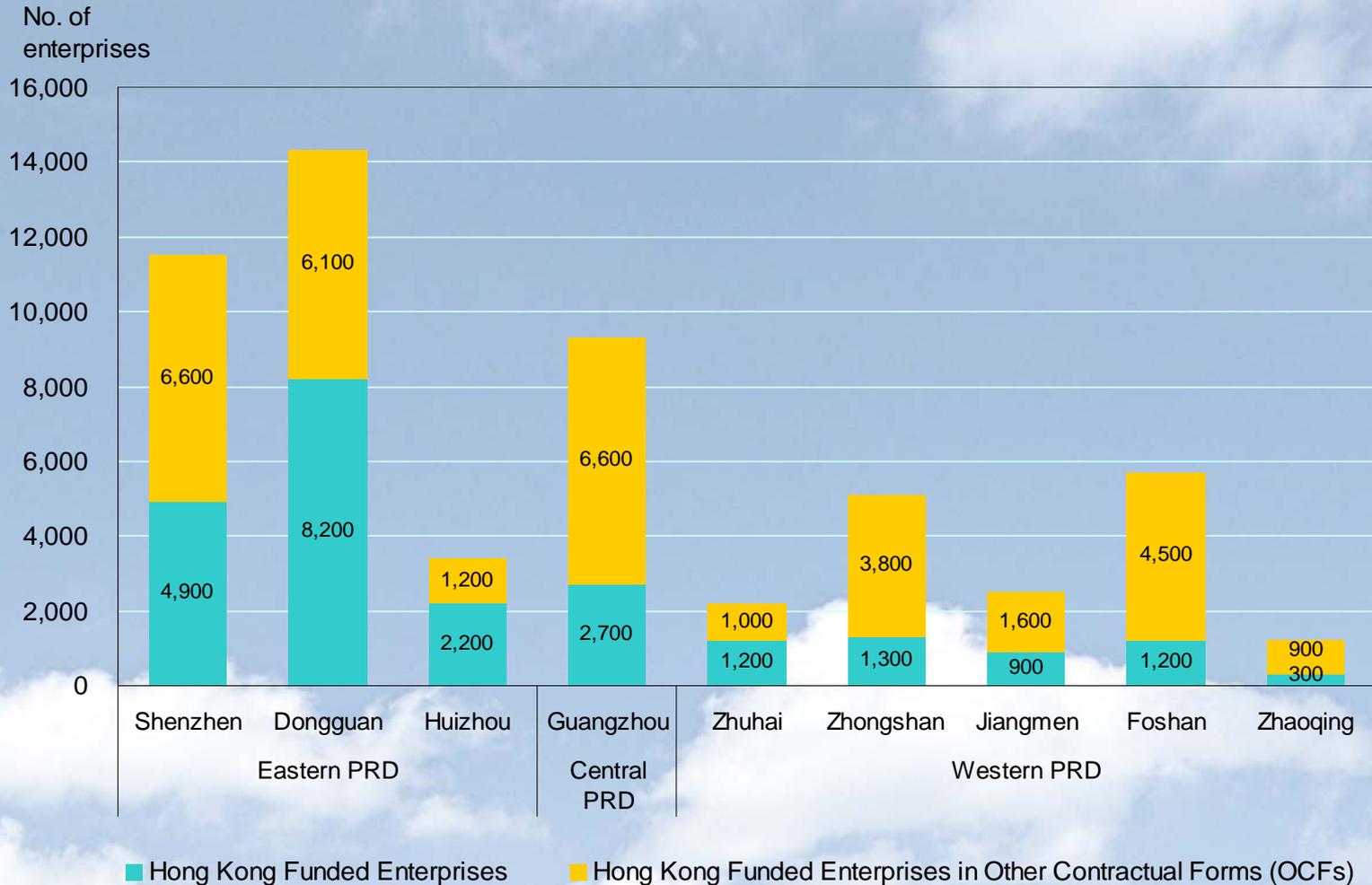
- Sampling Frame: The list of manufacturing enterprises of Guangdong's First Economic Census
- Our survey was conducted between 20 September 2005 and 10 March 2006
- The number of enterprises that were contacted and that responded to the selection test was 5,030
- There was 2,529 valid questionnaires
- Response Rate: 75%  
Success Rate: FIEs 67.5%  
Domestic Enterprises 39.4%

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# The Estimated Number of Hong Kong-funded Enterprises in PRD



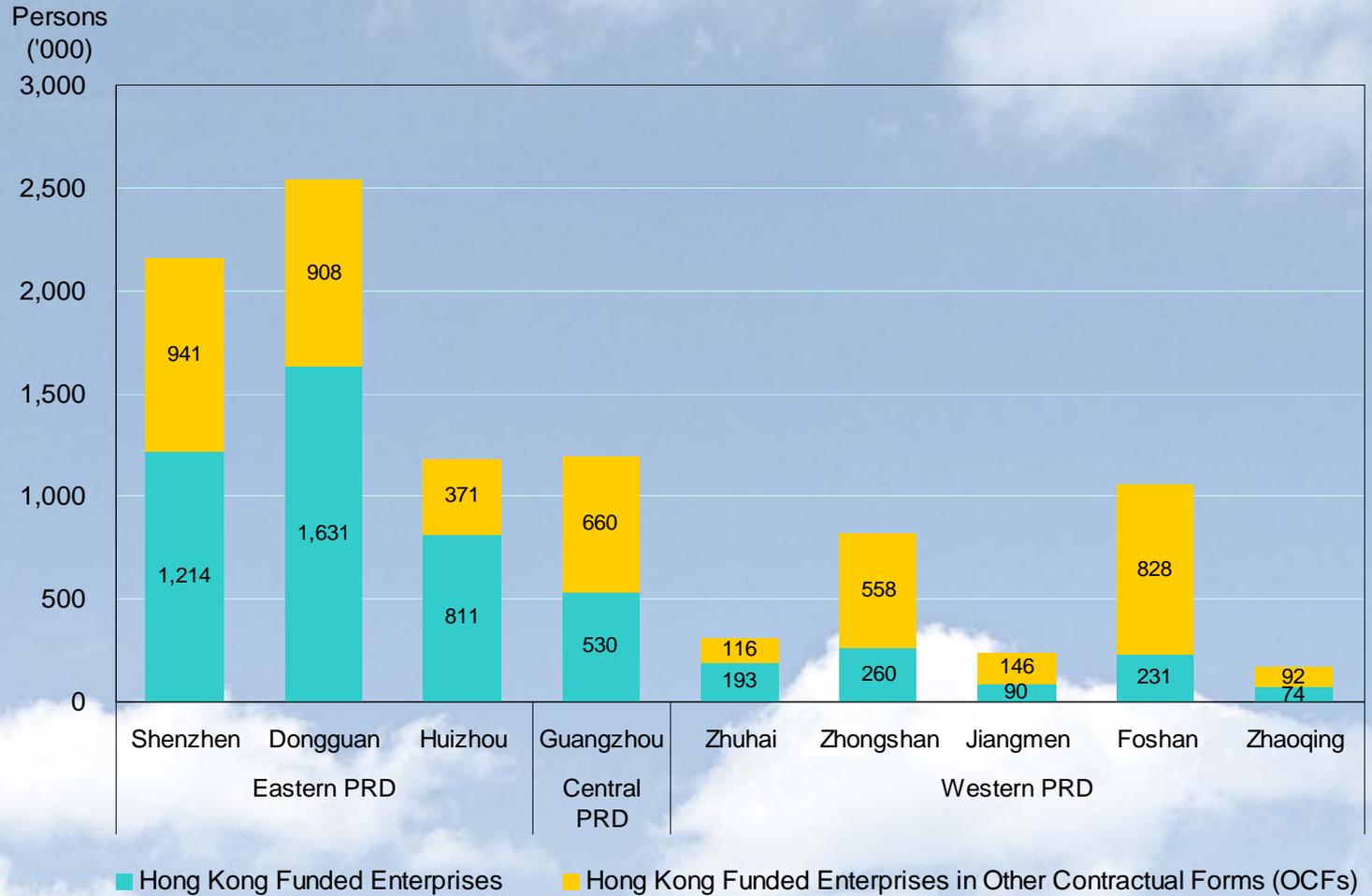


## The Estimated Number of Hong Kong-funded Enterprises and Hong Kong-funded Enterprises in OCFs

- Estimated about 55,200 Manufacturing Enterprises (about 57,500 Factories) in PRD
- One in every two enterprises was related to Hong Kong
- Hong Kong-funded enterprises (22,900) accounted for 72% of the total number of FIE
- Hong Kong-funded enterprises in OCFs (32,300) accounted for 41% of the total number of domestic enterprises



# The Estimated Employed Persons of Hong Kong enterprises in PRD





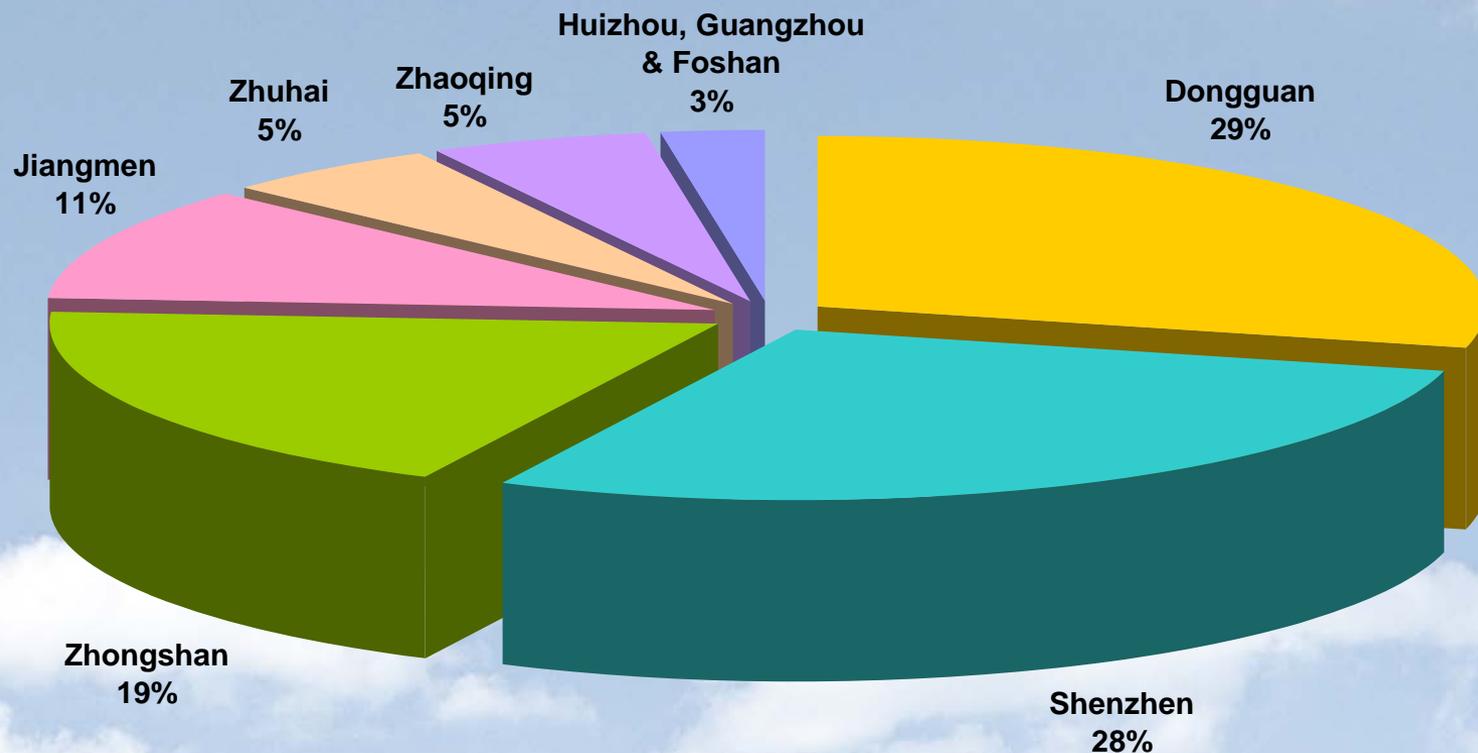
## Number of Employed Persons by Hong Kong-based Enterprises in PRD

- A total of 9.6 million employees were hired by Hong Kong-based enterprises in PRD
- 5 million were employed by Hong Kong-funded enterprises
- 4.6 million were employed by Hong Kong-funded enterprises in OCFs
- 2 million were hired by traditional enterprises engaged in TFP



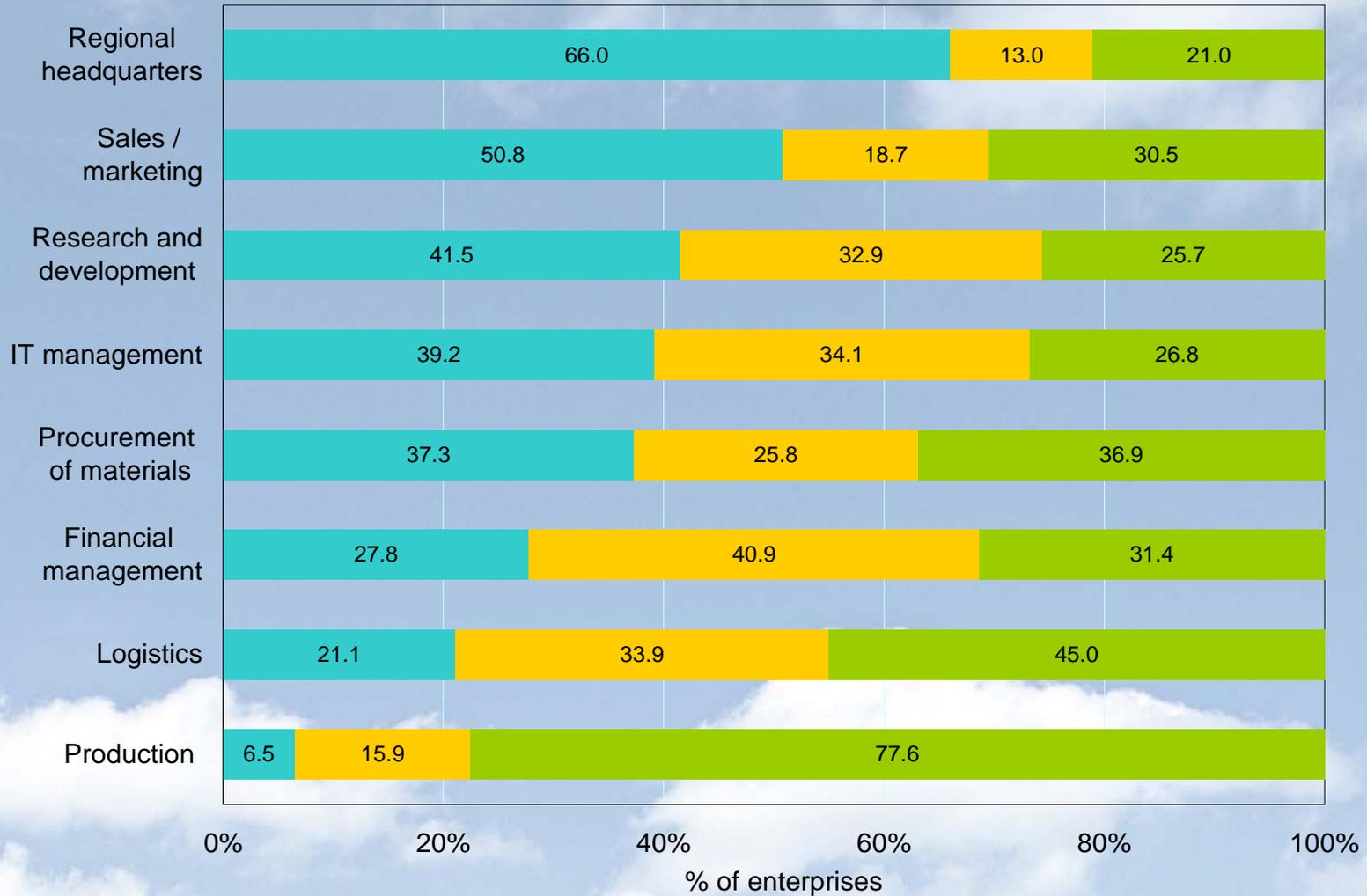
# The Distribution of Enterprises Engaged in Three Forms of Processing/Assembly Operations and Compensatory Trade (TFP) in PRD

About 14,000 Enterprises engaged in TFP





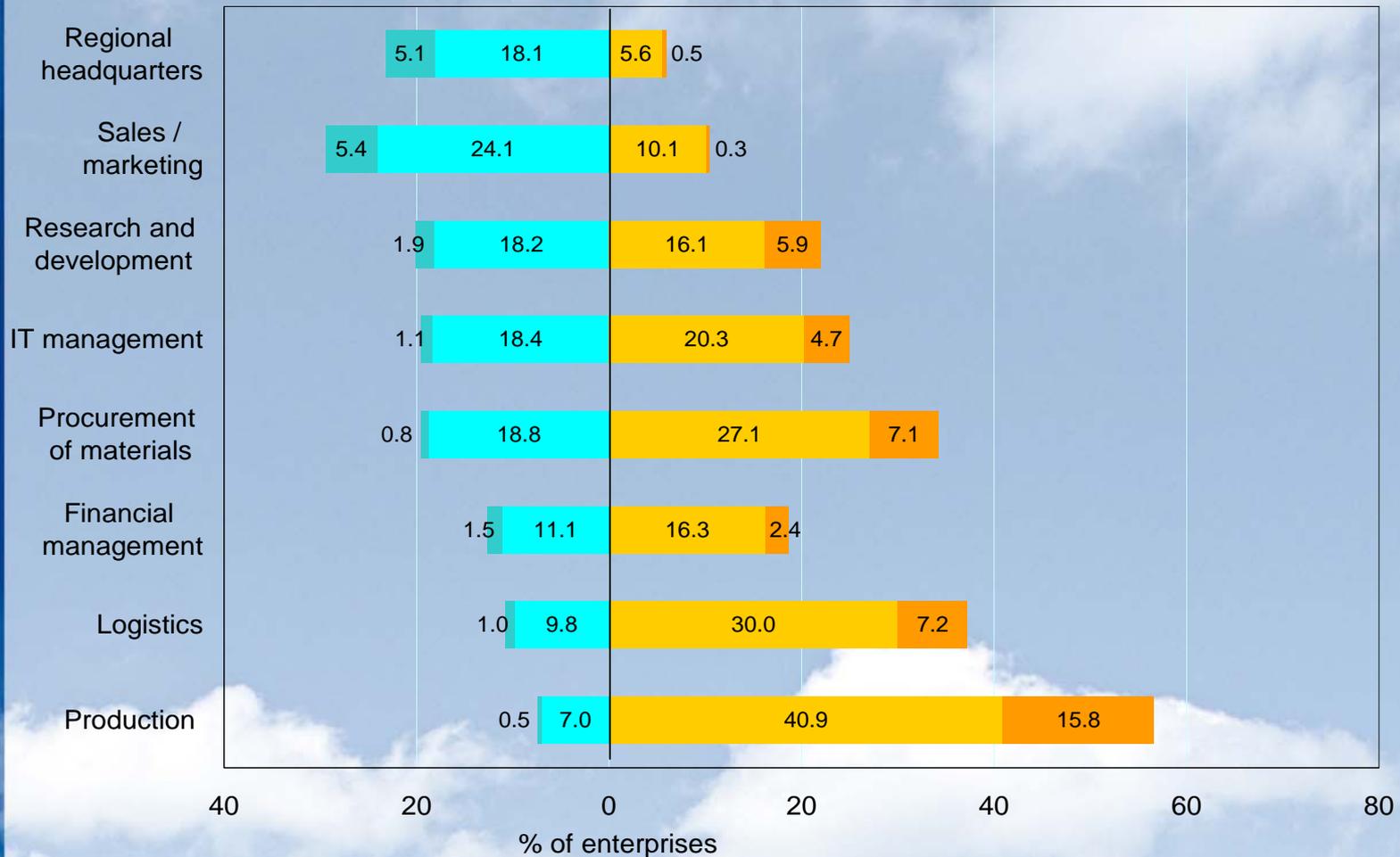
# Current division ...



■ Hong Kong    
 ■ Same share    
 ■ Guangdong



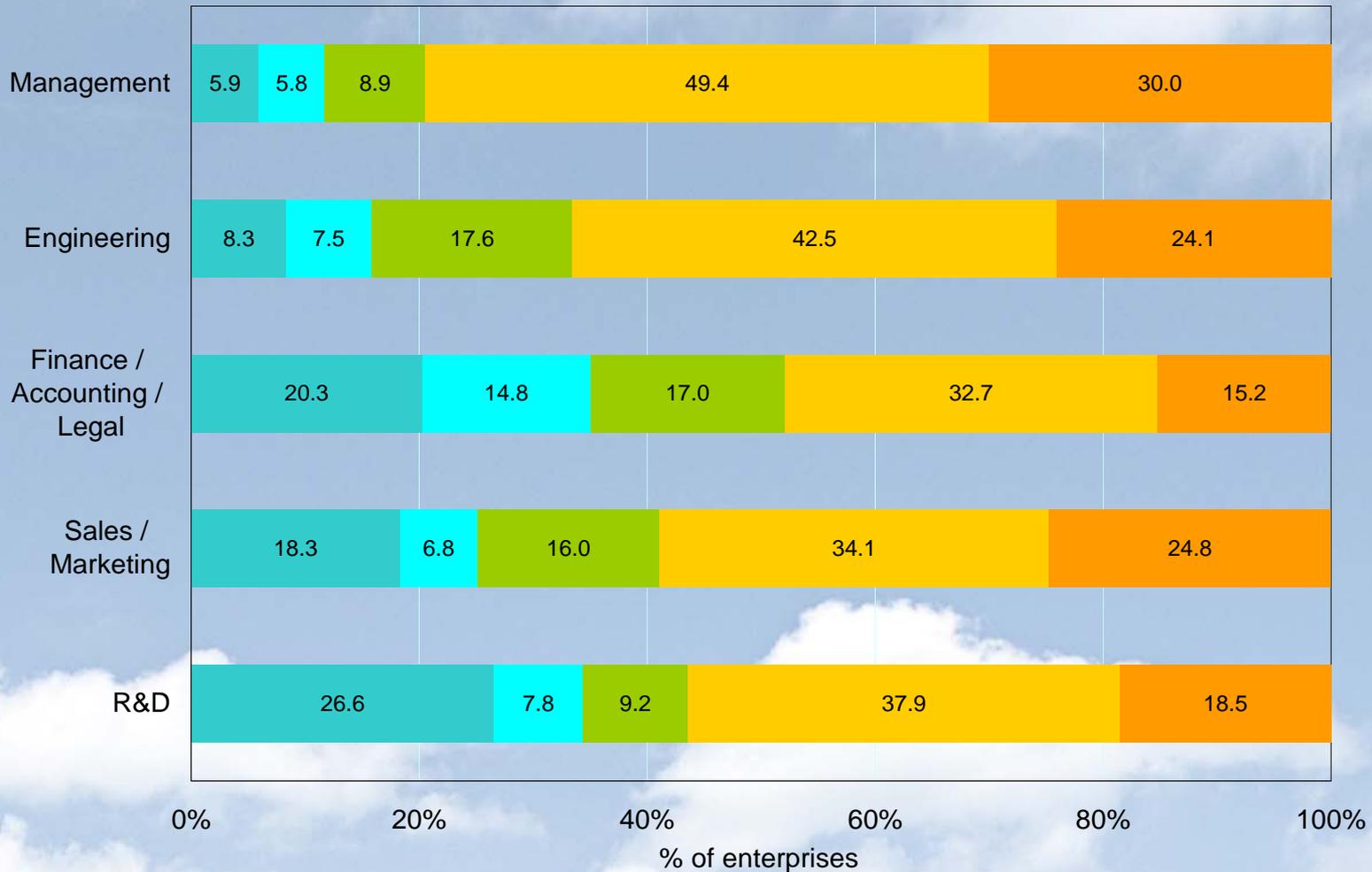
# Expected future division ...



■ Increase the share of operations in HK      ■ All operations in HK  
■ Increase the share of operations in GD      ■ All operations in GD



# Expected time for mainland employees to take over from HK employees by job functions



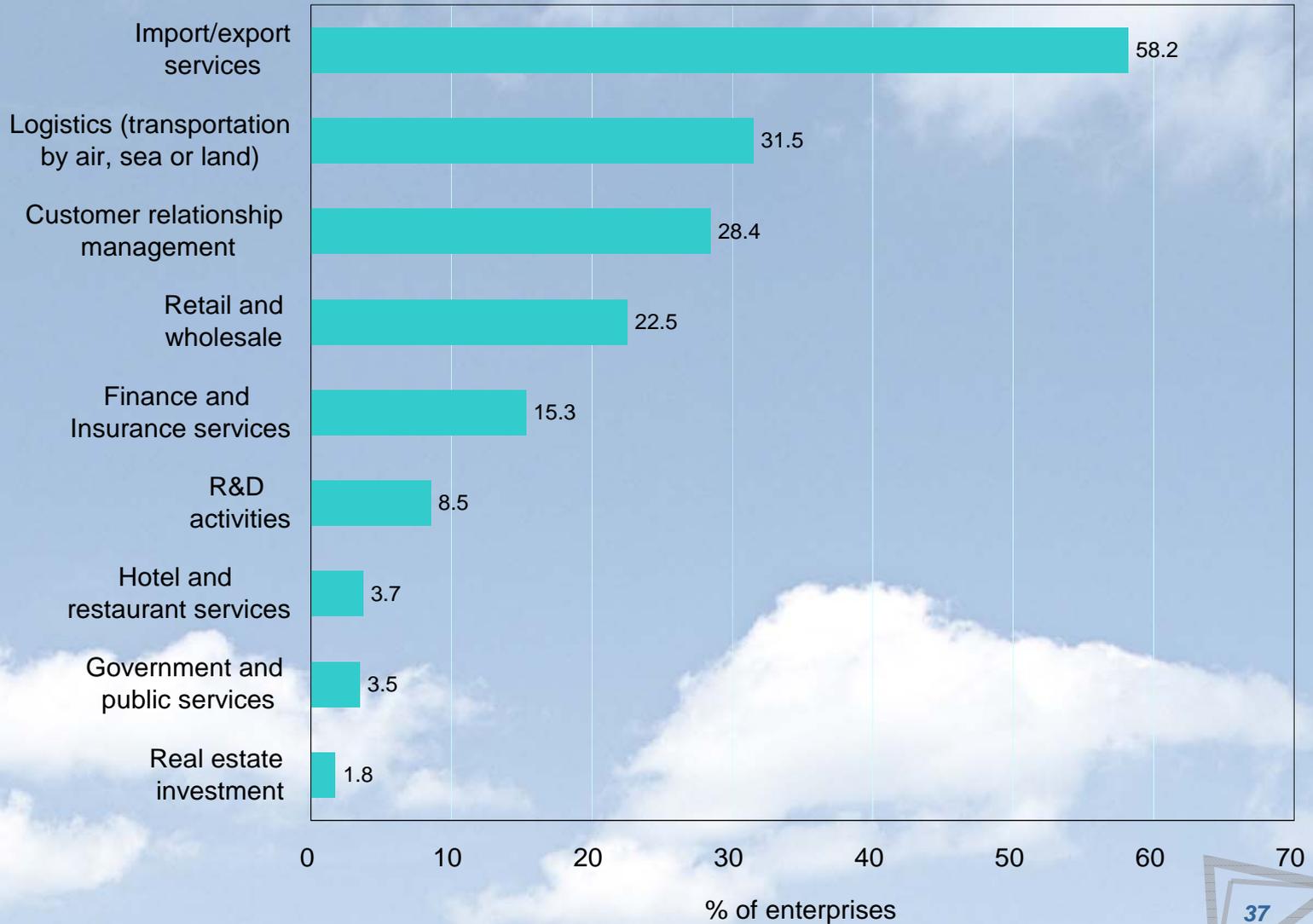
■ Have already been replaced  
 ■ No intention to replace

■ Within 5 years  
 ■ Do not know

■ More than 5 years

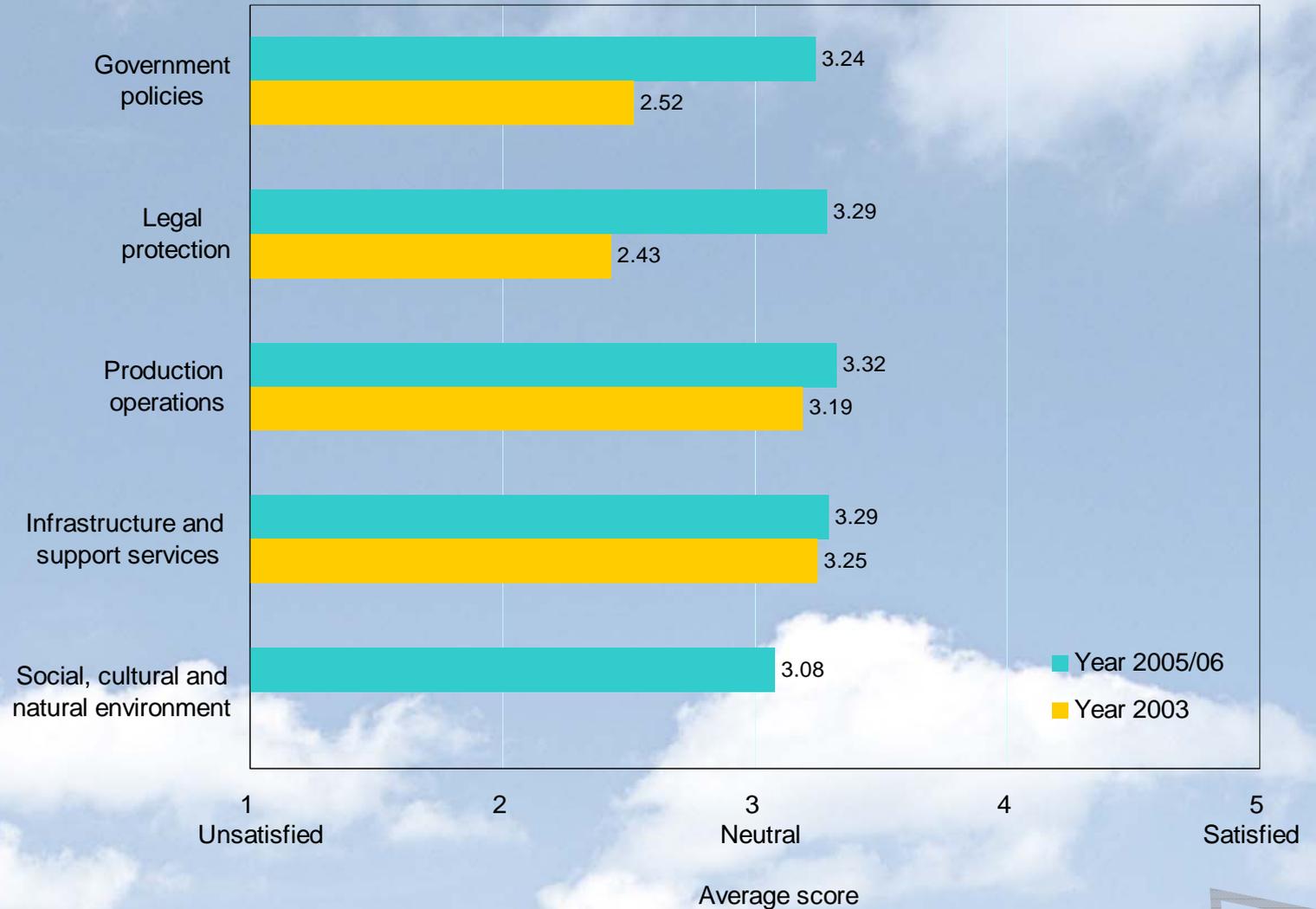


# Utilisation of Hong Kong's Service Industry



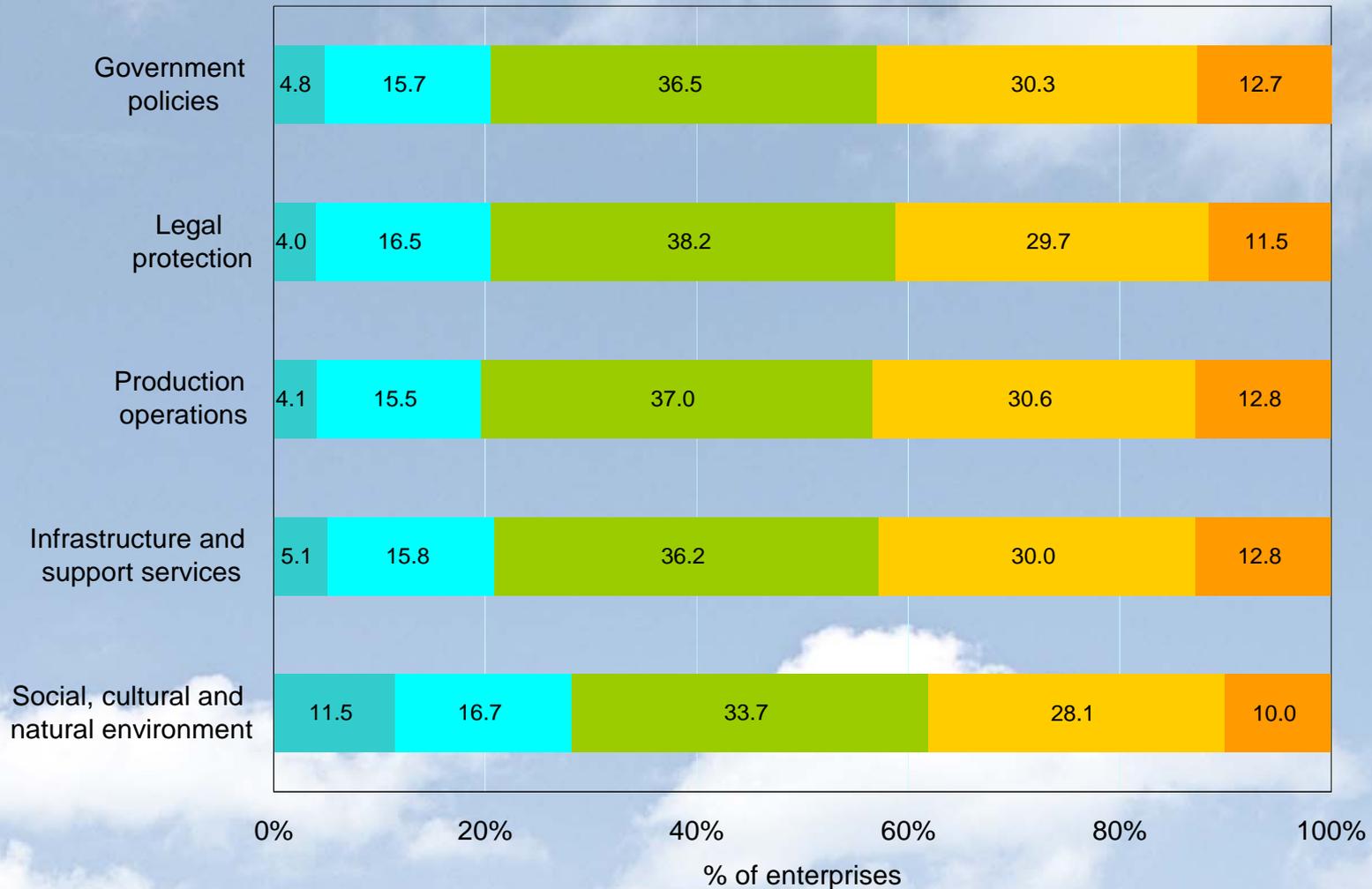


# Business Environment in PRD





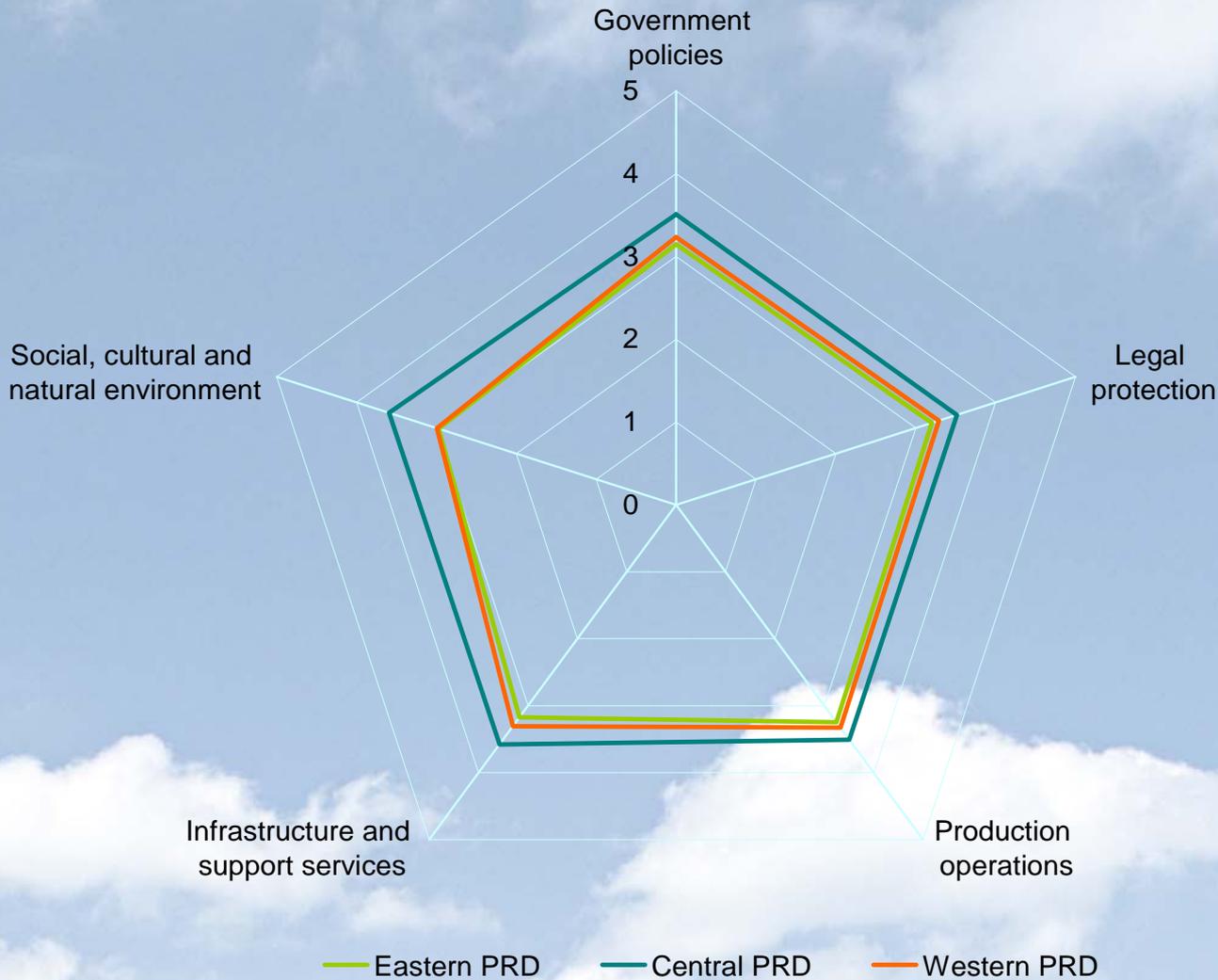
# Change in the Business Environment in PRD



■ Significantly deteriorated ■ Slightly deteriorated ■ Unchanged ■ Slightly improved ■ Significantly improved

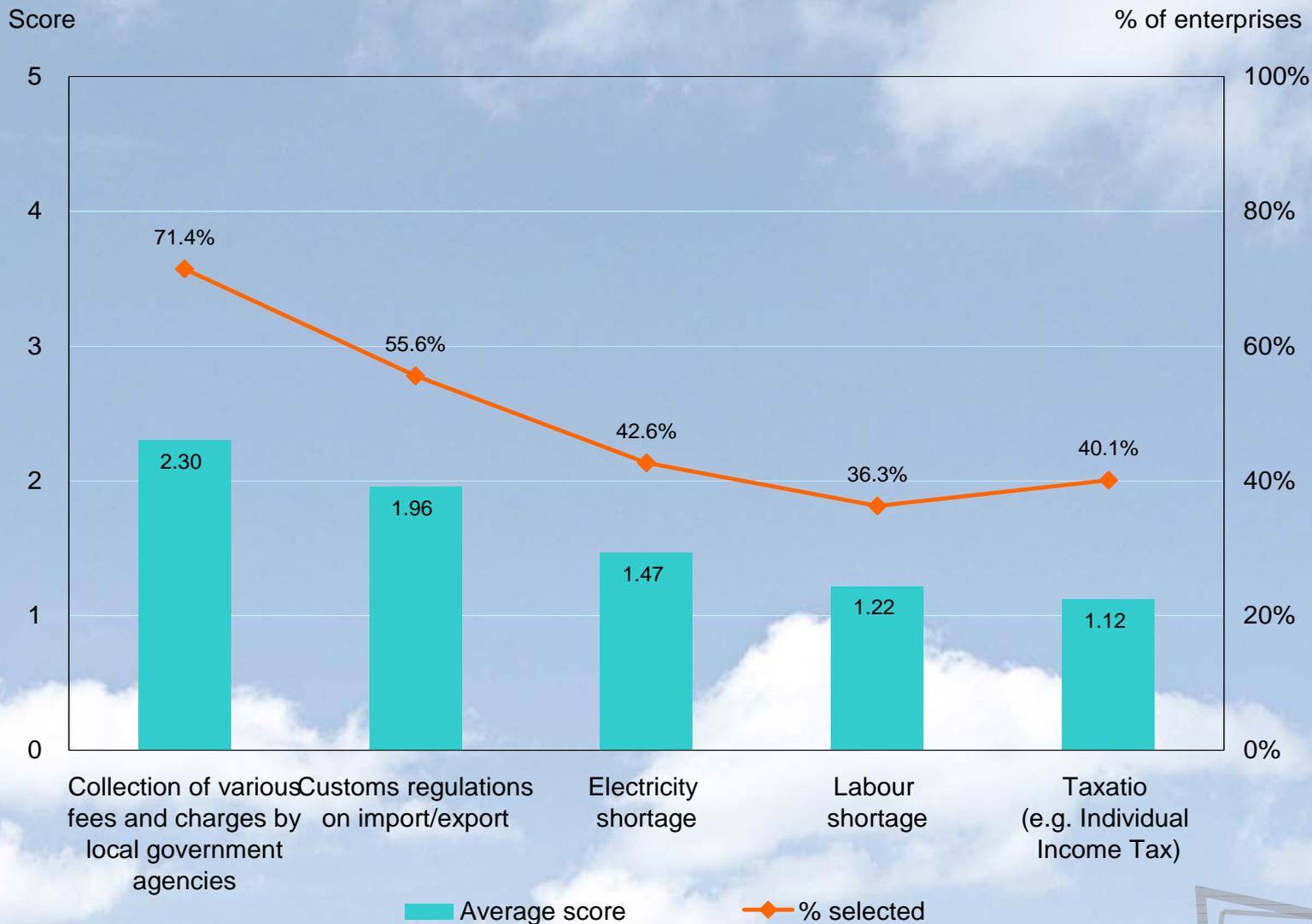
# Business Environment in Eastern, Central and Western PRD

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# Five Major Problems Encountered by Enterprises in PRD

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# Collection of various fees and charges by local government agencies

- The respondents were greatly troubled by the various types of taxes and charges levied on the Mainland (*Made in PRD(2003)* and this survey)
- The various types of taxes and charges paid by the surveyed enterprises accounted for about 9.8% of the operating cost
- Of which, 38.7% was central taxes, 44.9% was local taxes and 16.5% was charges and fines levied by district and township government

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## The business environment in Guangdong has continuously improved

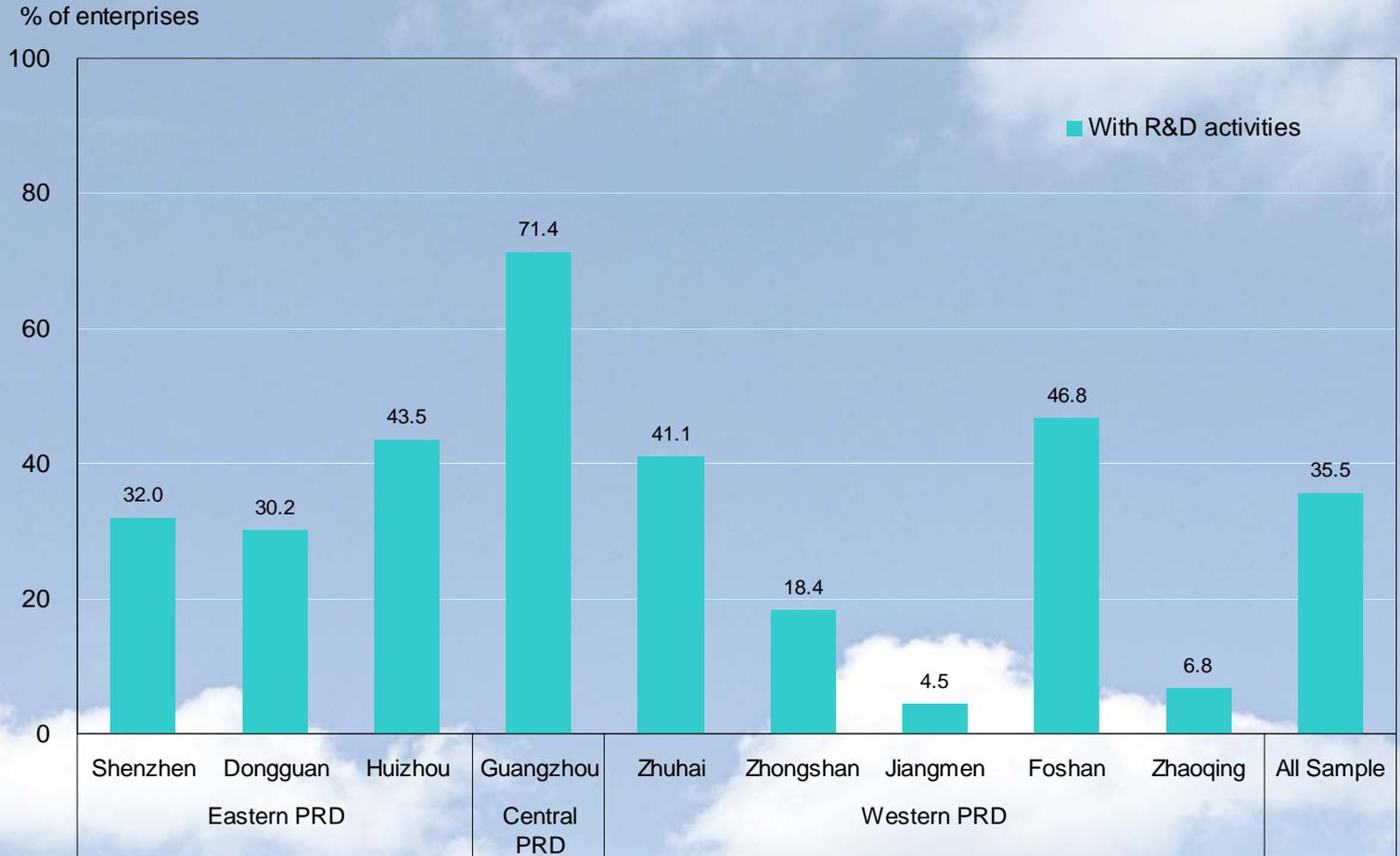
- About 62% of the surveyed enterprises had encountered problems of various kinds in business operations in past one to two years  
*(Made in PRD(2003): 97%)*
- Only 3% of the surveyed enterprises experienced customs delays in past one year  
*(Made in PRD(2003): 73.4%)*

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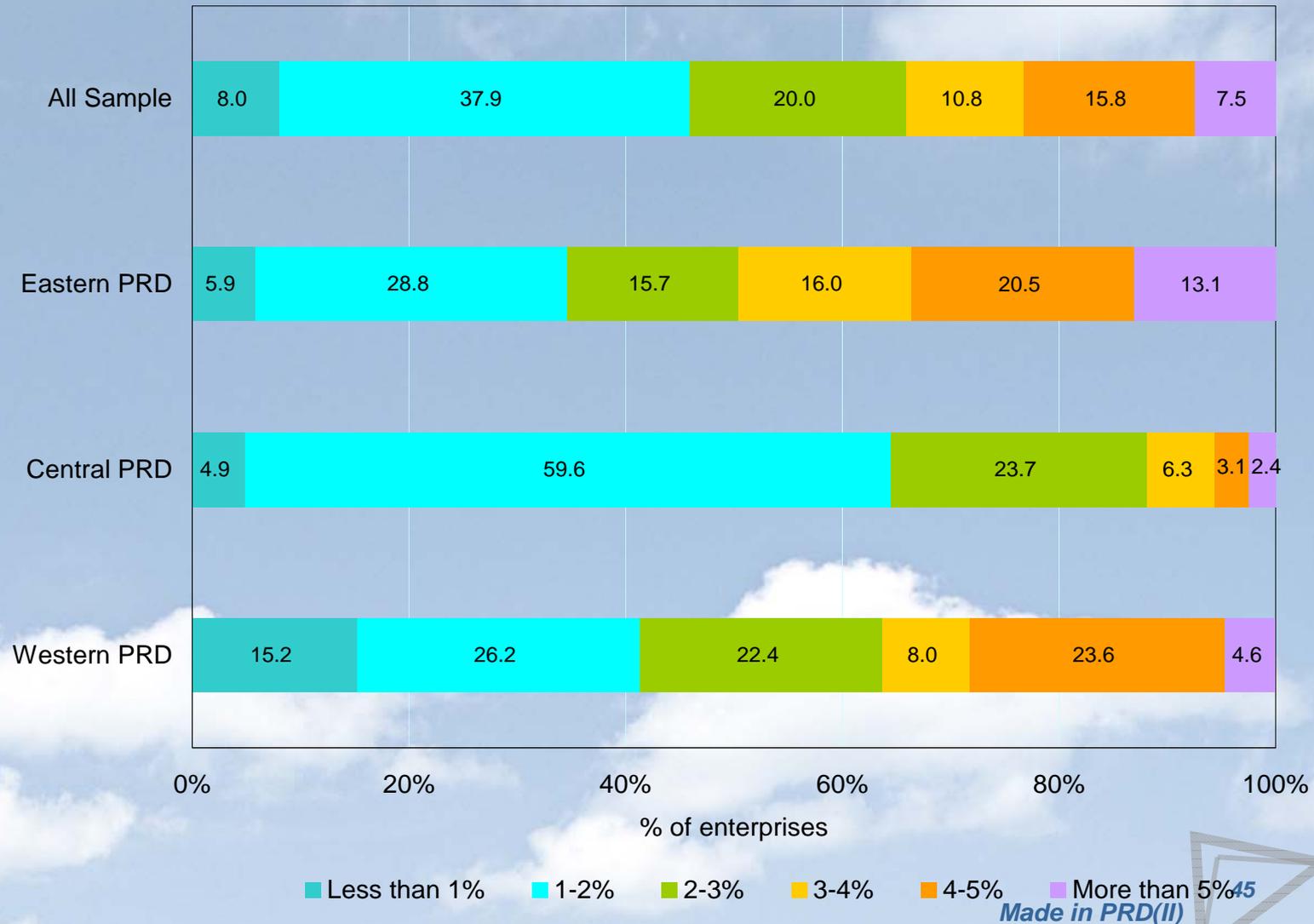


# R&D Activities of the surveyed enterprises in PRD





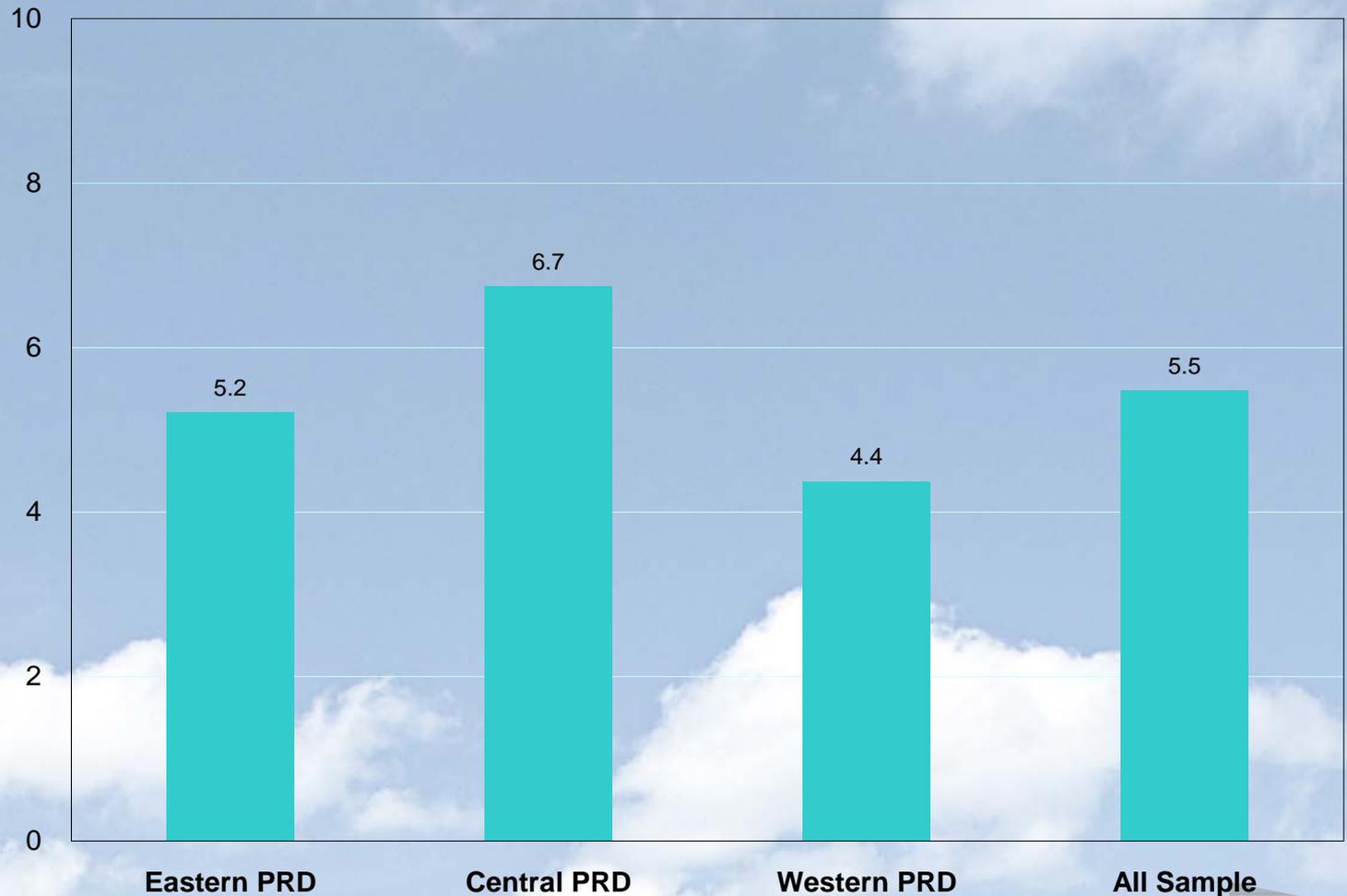
# R&D Expenditure to Turnover Ratio of the Enterprises in PRD





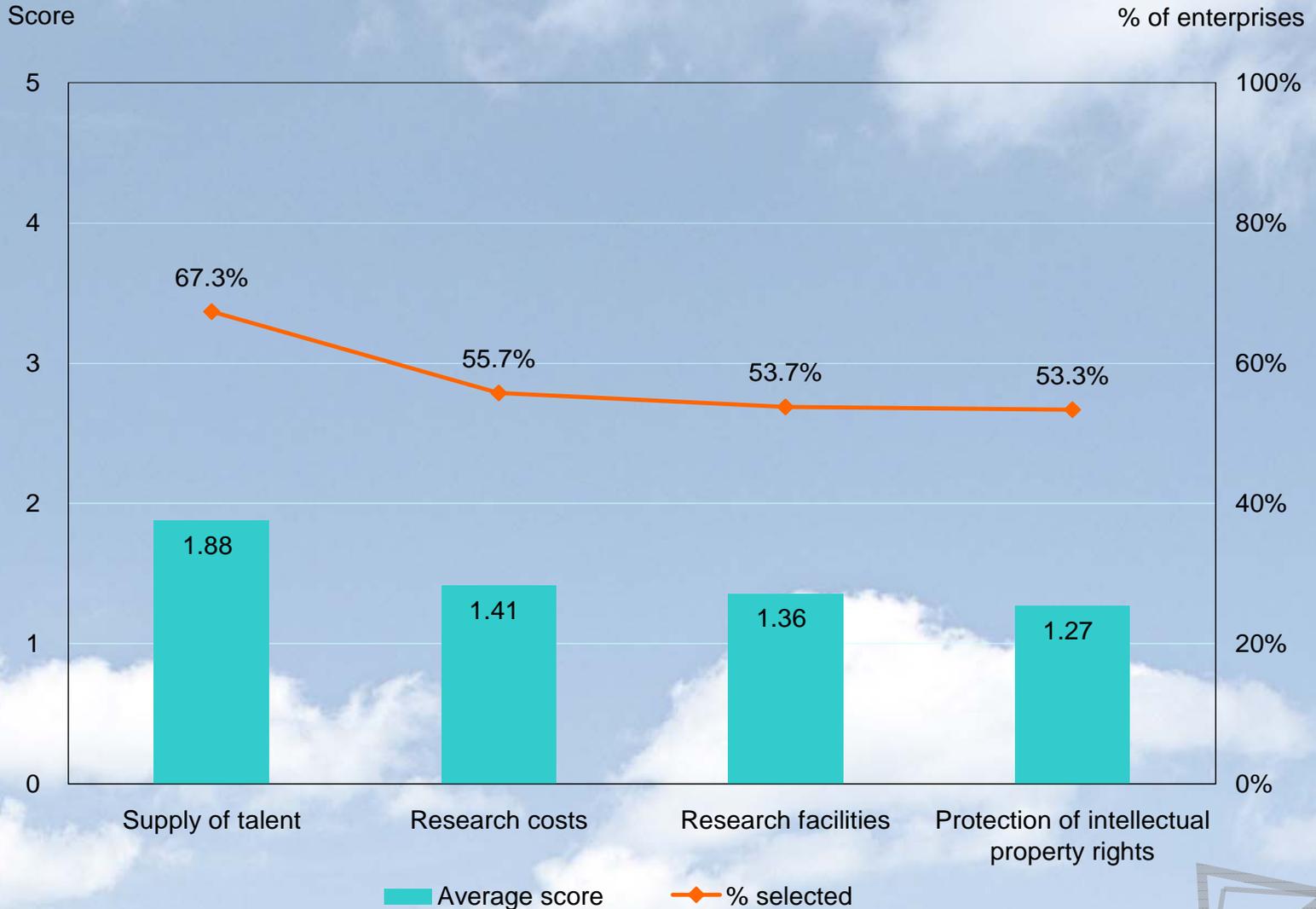
# Proportion of R&D Employees of Enterprises with R&D Activities

% of total employed  
persons





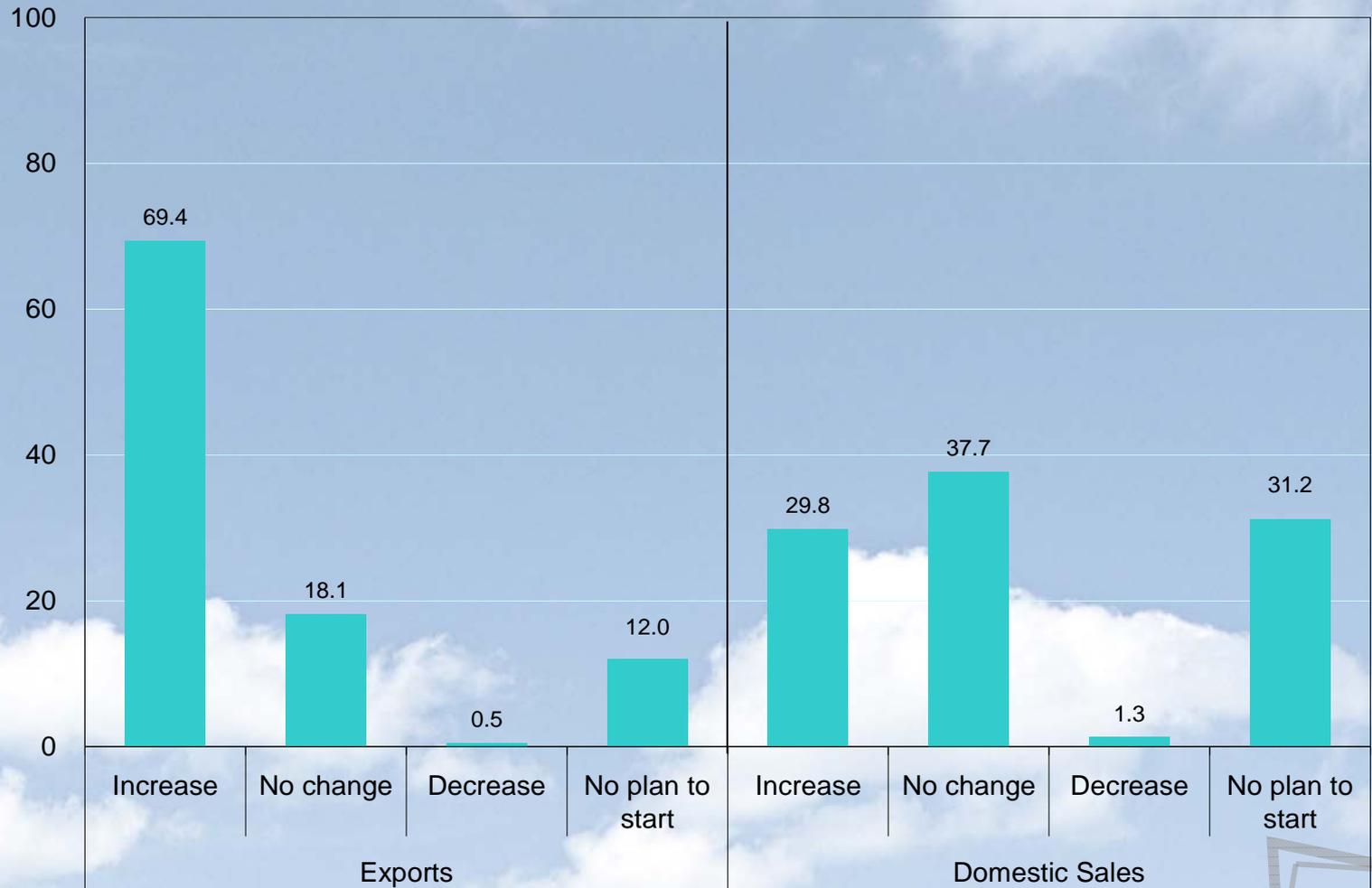
# Factors Determining R&D Locations





# Forecast of Exports and Domestic Sales Businesses in the coming two to three years

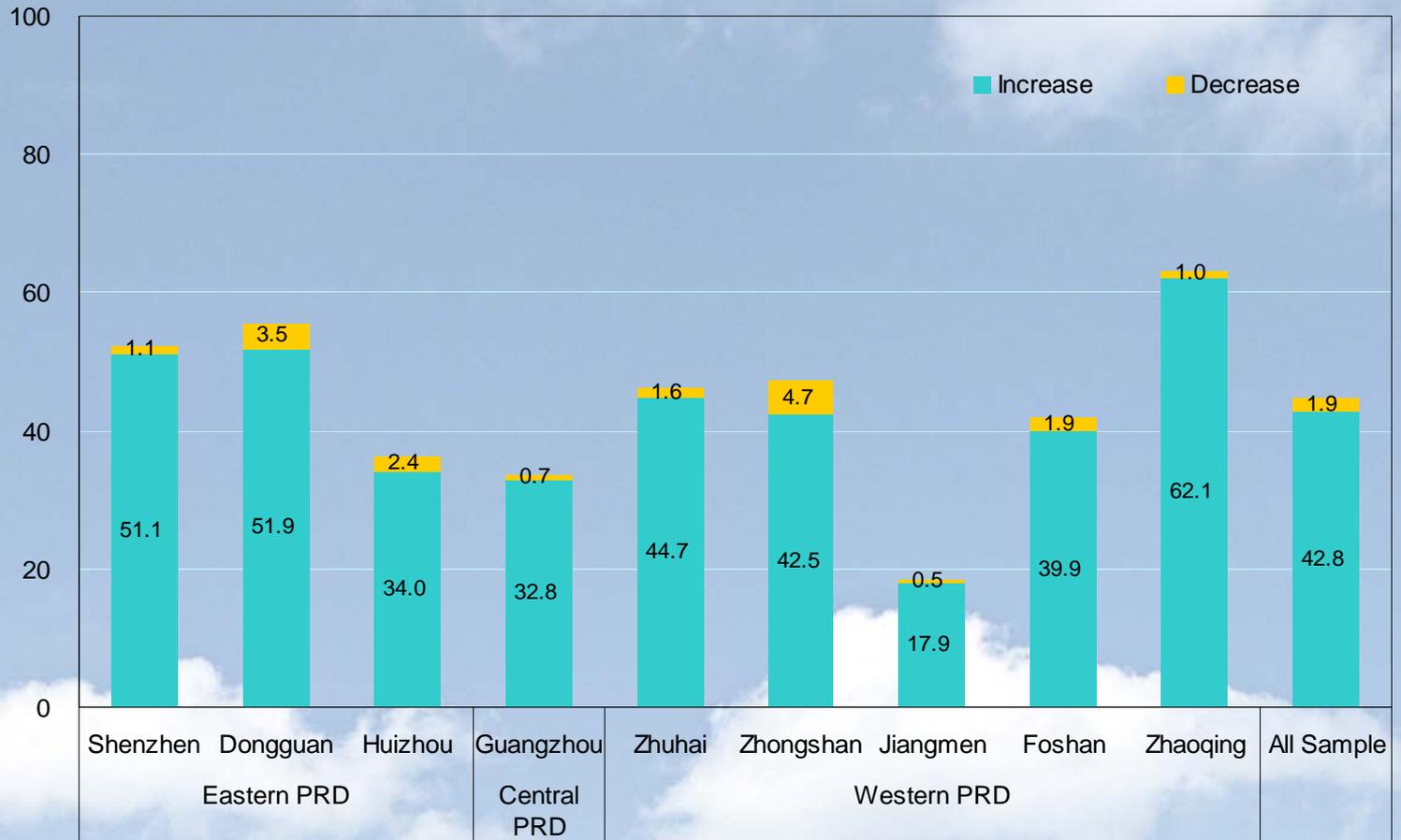
% of enterprises





# Future R&D Plans – R&D Expenditure

% of enterprises





# Main Science and Technology Indicators in OECD and Selected Non-member Asian Economies (2004)

	R&D as a percentage of GDP	R&D expenditure % performed by			Total Researchers Full Time Equivalent	Number of Utility Patents Granted by USPTO	Number of Utility Patents Per 1000 FTE researchers
	2004	Industry	Higher Education	Government	2004	2000-2004	2000-2004
<b>OECD Members Economies</b>							
Total OECD	2.26	67.9	17.1	12.5	3,559,133	782,690	45.2
United States	2.68	70.1	13.6	12.2	1,334,628	257,240	39.6
Japan	3.13	75.2	13.4	9.5	677,206	170,243	51.4
Korea	2.85	76.7	9.9	12.1	156,220	19,010	28.7
European Union-25	1.81	63.3	22.1	13.4	1,178,116	131,028	24.4
<b>Non-Member Economies</b>							
China	1.23	66.8	10.2	23.0	926,252	1,304	0.3
Hong Kong	0.74	41.0	56.0	2.0	18,846	1,236	17.7
Chinese Taipei	2.56	62.5	12.0	24.9	72,720	26,705	83.3
Singapore	2.25	64.4	11.6	23.4	21,359	1,800	18.9

Source : OECD, Main Science and Technology Indicators, 2006 Volume 1; Statistics on Research and Development in HK (1999-2003), Hong Kong Monthly Digest of Statistics June 2006



# R&D Expenditure and Personnel of Some Provinces of China and Hong Kong in 2005

	Total R&D Expenditure (RMB 100 Mn)	As % of GDP	Total Full-time Equivalent of R&D Personnel	of which : Scientists & Engineers	Total Domestic Patents granted in 2005
China	2,450.0	1.33%	1,364,799	1,118,698	171,619
Beijing	382.1	5.55%	171,045	147,591	10,100
<i>Rank</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>6</i>
Shanghai	208.4	2.28%	67,048	56,987	12,603
<i>Rank</i>	<i>4</i>	<i>3</i>	<i>6</i>	<i>6</i>	<i>4</i>
Jiangsu	269.8	1.47%	128,028	97,232	13,580
<i>Rank</i>	<i>2</i>	<i>6</i>	<i>2</i>	<i>3</i>	<i>3</i>
Zhejiang	163.3	1.22%	80,120	60,008	19,056
<i>Rank</i>	<i>8</i>	<i>8</i>	<i>5</i>	<i>5</i>	<i>2</i>
Guangdong	243.8	1.09%	119,359	101,223	36,894
<i>Rank</i>	<i>3</i>	<i>10</i>	<i>3</i>	<i>2</i>	<i>1</i>
Hong Kong(2004) (HK\$100 Mn)	95.1	0.74%	18,846	14,594	

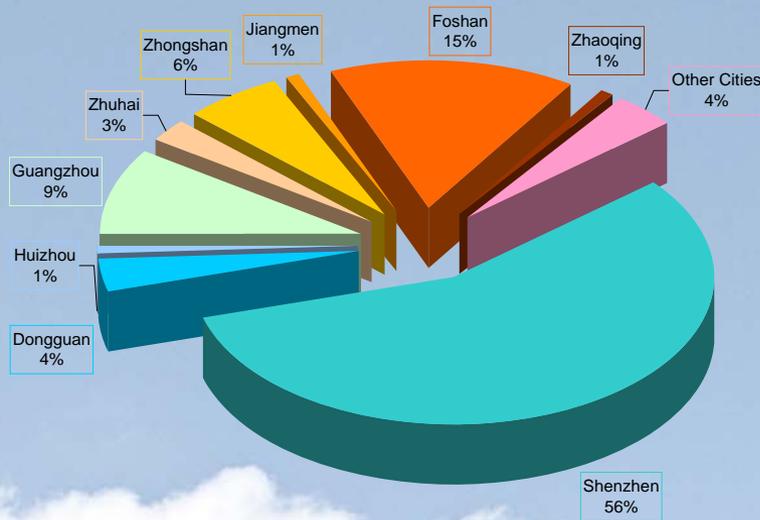
\* Business #Government @Manufacturing

Source : China Statistical Yearbook 2006, China Statistical Yearbook on Science and Technology 2006, Hong Kong Monthly Digest, June 2006

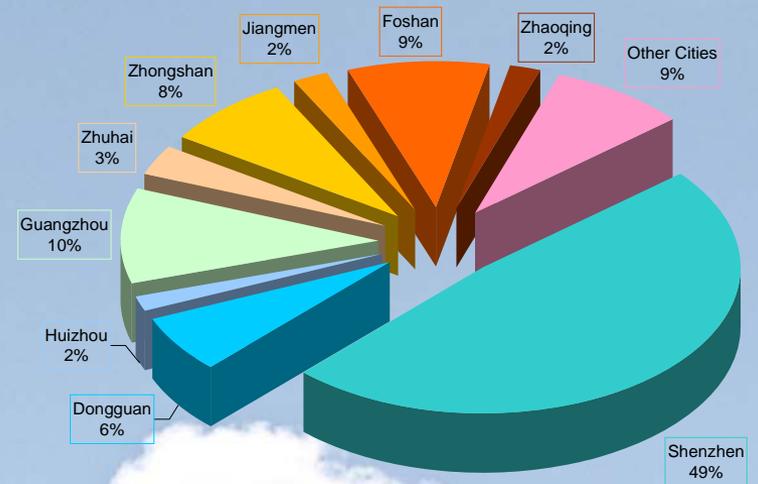


# R&D Expenditure and Full Time Equivalent (FTE) Staff in PRD 2005

## R&D Expenditure



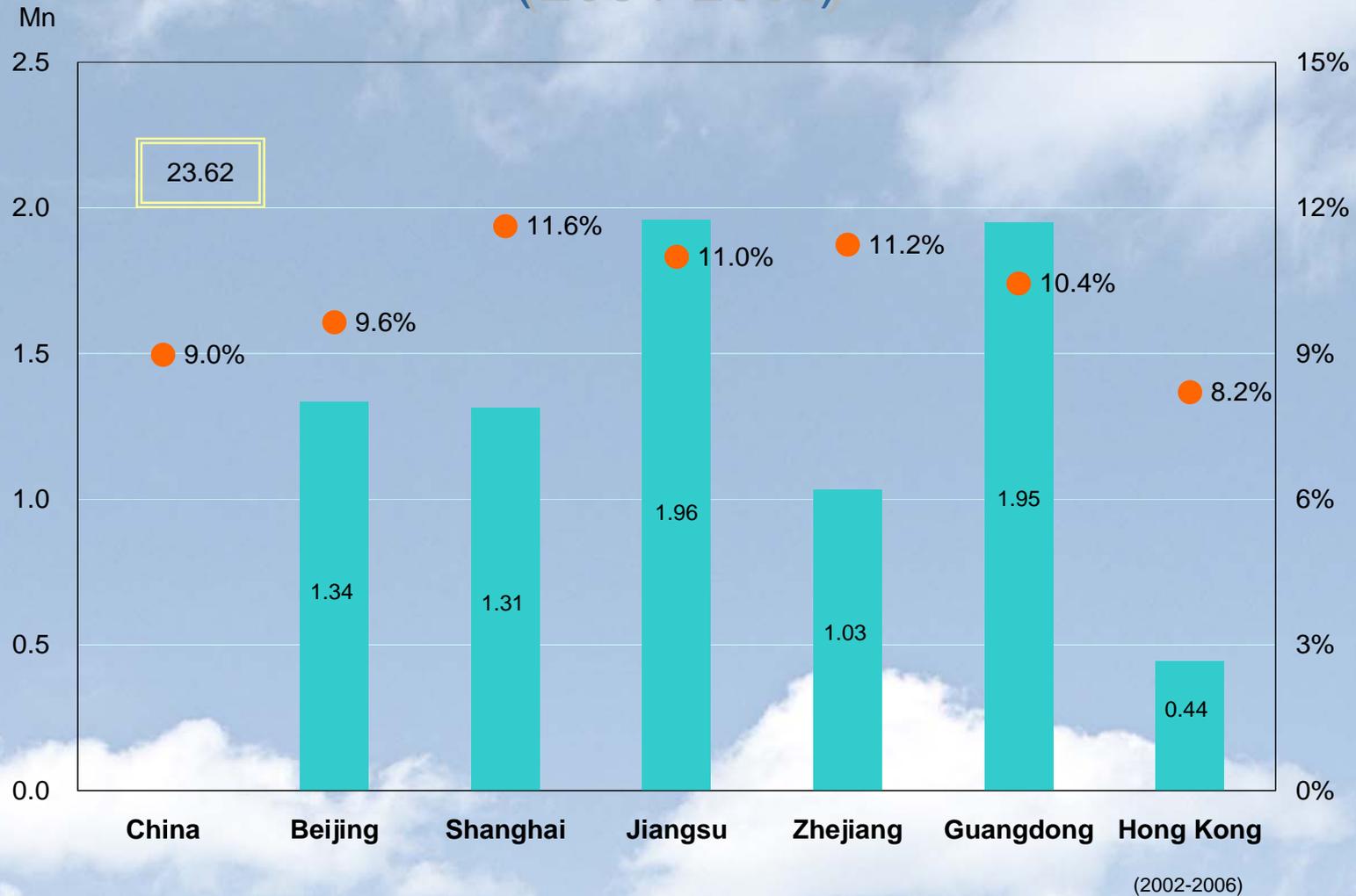
## R&D FTE Staff



Source: Guangdong Provincial Bureau of Statistics



# Net Increase of Population with Tertiary Education (2001-2005)



■ Net Increase of population with tertiary education  
● Average Annual Growth Rate of Population with tertiary education



## Foreign investment drove the flow of human resources

- Population with tertiary education in Guangdong and Greater YRD grew at a rate faster than that of China
- A lot of inland talent was attracted to working in Guangdong because of its rapid economic development in the 1990s
- During 2001-2005, the Greater YRD attracted tertiary education population at a rate faster than Guangdong



## Major Findings...

- The borderline between foreign-invested enterprises and domestic enterprises in the PRD is becoming blurred.
- The cooperation between Hong Kong enterprises and Guangdong enterprises is more equal than before.
- The relationship between Hong Kong and Guangdong has gradually developed into a complicated and diversified division of labour from the style of “shop in the front and factory in the back” in the past.
- The business model has gradually transformed into a dual pattern, combining export and domestic sales instead of concentrating solely on an export-oriented mode



# Hong Kong - Key Challenges

- Much closer and arguably better integrated with the rapidly growing domestic Mainland market
- Relaxing the restrictions on the inflow of entrepreneurial talent from the Mainland



# What can be done by the Hong Kong Government?

- Maintain a Good Business Environment
- Coordinate Hong Kong's Infrastructure Development with Guangdong Province
- Provide Assistance to Hong Kong Companies Encountering Commercial Disputes in Guangdong Province
- Strengthen Hong Kong's R&D Capabilities
- Reduce the barriers relating to admission of Mainland talent and technology personnel to Hong Kong for work or study
- Help government-funded NGOs to establish themselves across the border



# Guangdong - Key Challenges

- Formulating feasible rules in line with actual development and unifying the standards of law enforcement
- The upgrading of industrial structure has to be market driven and proceed in an incremental way. Abrupt policy changes must be avoided to safeguard the existing competitiveness and allow the establishment of new comparative advantages.

# What can be done by the Guangdong Government?

- Streamlining and reducing various fees charged by the government
- Accelerating the construction of the electricity supply and transportation infrastructure
- Establish an efficient and effective communication mechanism and forum with Hong Kong Manufacturers
- Reduce red tape and bureaucratic procedures that obstruct foreign investors from entering the domestic market
- Open the vocational and professional training sector to Hong Kong institutes
- Upgrade of manufacturing industries in Guangdong through a market-driven mechanism rather than administrative fiats

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PRD



# What can be done by the Guangdong and Hong Kong Governments?

- Address the issue of environmental degradation in PRD together and provide practical solutions to enhance the prospect of sustainable development for the whole region
- Join hands to promote the Greater PRD region's strategic position as a gateway for international companies to enter the Mainland market and a springboard for Mainland companies to reach out to the world market
- Ensure good co-ordination on the planning of transportation and aviation infrastructures
- Increase the feasibility of Hong Kong Service Providers to do business or practice in Guangdong and Pan-PRD under CEPA
- Facilitate Outward Processing Operations in Mainland China to enter the Mainland Market
- Facilitate flows of people and goods across the borders

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# Thank You